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Property Insurance: No Solution for Pollution

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PROPERTY INSURANCE: NO SOLUTION FOR POLLUTION†

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I. INTRODUCTION

Recent nationwide developments have highlighted the importance of examining potential coverage for first-party contamination claims under property insurance. The staggering cost of cleaning up pollution has triggered a search for insurance funds to pay for this effort. The primary focus of disputes to recover insurance proceeds has been an insurer's duty to defend or indemnify an insured under a policy of Comprehensive General Liability (CGL) insurance. Property insurance policies, however, are fast becoming a new target for claims to recover losses caused by contamination.¹

Several factors have contributed to the growing trend toward seeking property insurance coverage. Governmental agencies at all levels have stepped up the pressure on property owners to correct

¹ See generally Business Insurance, Nov. 6, 1989, at 92, col. 4 (reporting on the increased incidence of claims under property insurance policies for coverage to pay the costs of cleaning up hazardous wastes pursuant to governmental order). See also Glad & Barnes, *The Final Frontier: First-Party Environmental Claims*, INS. LITIG. REP., Jan. 1990, at 3. Glad and Barnes predict that "much of the emphasis in the future coverage litigation for hazardous waste claims will be in the virgin field of first-party [property] coverage." *Id.*

the environmental hazards on their own property. The public is more aware of the heightened risk of damage to property and the enhanced threat to human health posed by asbestos, toxic waste, and other harmful pollutants. In light of the recently expanded pollution exclusion in post-1986 CGL policies,² CGL funds to pay for cleaning up contaminants will become less available. These factors, in conjunction with the near absolute unavailability of environmental impairment liability coverage,³ have contributed to an increase in contam-

² The 1986 revised pollution exclusion differs significantly from previous versions. There is no longer an exception for the "sudden and accidental" emission of pollutants. The deletion should avoid the problems of interpretation that resulted when many courts found these words to be ambiguous. Further, claims based on threatened and alleged emissions are excluded under the revision. The latter change should exclude coverage for actions seeking injunctive relief against the insured to prevent imminent future pollution. For a discussion of the 1986 revision and its implications on comprehensive general liability (CGL) insurance coverage for pollution claims, see Gordon & Westendorf, *Liability Coverage for Toxic Tort, Hazardous Waste Disposal and Other Pollution Exposures*, 25 IDAHO L. REV. 567, 603-607 (1988-89).

³ Environmental Impairment Liability (EIL) insurance is not presently available for purchase. EIL coverage was developed by the Insurance Services Office, a statistical and rating organization associated with the insurance industry, and was meant to comply with the financial responsibility requirements established under the Resource Conservation and Recovery Act (RCRA), 42 U.S.C. §§ 9605-9675 (1982 & Supp. V 1987). Coverage was provided under EIL policies for gradual—non-sudden—pollution damage liability due to property damage, bodily injury, and other losses arising both on and off the insured's premises. EIL policies not only covered the business or entity insured, but also provided coverage for directors, officers, and employees of the insured who were acting within the scope of their corporate duties. The policy was offered on a claims-made basis, that is, coverage was provided only for qualified liability claims that the insured became aware of and reported to the insurer during the policy period.

The coverage proved to be unpopular with insureds because of the high premiums and the extremely limited coverage that insurers were willing to issue on a location-by-location basis. EIL insurance presented problems for the insurance industry because such coverage was very risky for insurers and posed the potential for heavy losses. Therefore, an insurer sought a great deal of information about its insured's operations in order to assess the risk prior to issuing coverage. As part of the application process to obtain EIL coverage, the insured was asked to provide a location description, to disclose all raw and process materials used, and to supply information regarding environmental and safety officials at the site, and effluent-discharge and waste-disposal information. Also, the insured was asked to provide a statement regarding its pollution-enforcement history and known conditions at its premises that could give rise to environmental claims. Following receipt of such information, the insurer ordinarily conducted an on-site risk assessment through an engineering firm hired by the insurer. The engineer would report to the insurer with a recommendation that the risks were too high, that further inspection should be conducted, or that the insurance should be written. Another reason for the unpopularity of EIL coverage with insureds is that the statements made in the policy application and during the risk assessment conducted by the insurer were thought to provide a roadmap for discovery in subsequent hazardous waste liability litigation. See generally DORE, *LAW OF TOXIC TORTS*, § 28.18 (1988); Kunzman, *The Insurer as Surrogate Regulator of the Hazardous Waste Industry: Solution or Perversion*, 20 FORUM 469, 476-78 (1985); Del Tufo & Rohn, *The Impact of Environmental Regulations on Business Transactions 1988: Real Property Transfers and Mergers and Acquisitions, and Environmental Liabilities*

ination claims under property policies. The question of whether coverage for such claims exists under homeowners and commercial property policies, however, has gone largely unexplored.⁴

During the 1990s most property insurers will be presented with first-party claims for losses arising from damage caused by the removal of toxic waste, asbestos, or other harmful pollutants. It cannot be predicted with certainty how the respective courts in each jurisdiction will rule on claims for property insurance coverage for contamination losses and clean-up expenses. Nevertheless, this Article analyzes noteworthy defenses to such claims under standard property insurance policies. The Article further argues that property insurance policies should not cover, and were never intended to cover, pollution-related losses.

The Article begins by addressing the potential for conflicting interpretations of coverage, and discusses the possible bases that may be alleged by insureds in favor of coverage under the prevalent policy forms for property insurance.⁵ Policy defenses that should exclude property insurance coverage for environmental losses are analyzed. These defenses include relying upon the coverage requirements of direct loss, comprising fortuitous physical damage to covered property, with no increase of hazard.

and *Insurance Coverage Issues: An Overview* (322 Practising Law Institute publication 561) [hereinafter PLI/REAL], Dec. 1, 1988, at 51-52; Hyman, *Toxic Liability in Real Estate Transactions*, 325 Practising Law Institute Course Handbook on Real Estate Development and Construction Financing 837 (Feb. 1, 1989); *Developments in the Law—Toxic Waste Litigation*, 99 HARV. L. REV. 1458, 1577-78 (1986).

⁴ The few articles addressing this question are: MALLIN, *POLLUTION AND CONTAMINATION: HOW WILL PROPERTY INSURERS RESPOND?* (1986); Butler, *Quarantining the Contamination Exclusion*, in *THE ALL RISK POLICY: ITS PROBLEMS, PERILS AND PRACTICAL APPLICATION*, 1986 ABA SEC. TORT AND INS. PRAC. 367; Hook, *Legal Aspects of Contamination and Pollution Coverage* (May 17, 1989) (unpublished manuscript presented at the Property Claims Forum of Sacramento); PROPERTY LOSS RESEARCH BUREAU QUESTION & ANSWER SERV., 85.1 *Contamination by Asbestos* (Oct. 1985); articles reprinted in *Environmental Claims and Property Insurance Coverage*, 1989 ABA SEC. TORT AND INS. PRAC. [hereinafter *Environmental Claims*]; Glad & Barnes, *supra* note 1, at 3. See also Paris, *Asbestos in Buildings, Property Coverage Claims*, in *ASBESTOS PROPERTY DAMAGE CLAIMS SEMINAR COURSEBOOK* 906C (Def. Res. Inst. June, 1989); Hall & Hall, *Property Insurance Coverage for Asbestos Removal Costs*, in *ASBESTOS IN BUILDINGS: THE LAWS, THE COSTS, THE SOLUTIONS* 237 (1988).

⁵ The most commonly used property insurance forms provide all risk coverage, or named peril coverage for specified risks that include hail, windstorm, fire, smoke, vandalism/malicious mischief, and explosion. Primary property insurance policies also include debris-removal coverage. S. HUEBNER, K. BLACK JR. & R. CLINE, *PROPERTY AND LIABILITY INSURANCE* 150-60, 556-63 (2d ed. 1979) (describing the predominant combinations of "packaged" insurance coverages that are marketed as homeowners and commercial property policies); see also *infra* notes 6, 8.

Apart from the defenses showing that environmental claims often fall outside the scope of standard property insurance, one or more exclusions from coverage frequently direct that property insurance should not be triggered in pollution claims. Policy clauses affirmatively barring coverage for environmental losses include exclusions for losses or damage to land, the omission of water from the definition of covered property, and the exception from coverage of loss or damage due to contamination.

The Article examines modern revisions to standard policy forms clarifying that little or no coverage is intended under property insurance for environmental risks, absent a special endorsement expressly providing such coverage. Then, the Article reviews other defenses that may preclude coverage based on the policy period, contractual limitation period, or untimely notice of the claim.

Additionally, the Article discusses public policy considerations which suggest that the costs of cleaning up the environment should be borne by polluters and not by their property insurers. Finally, the Article encourages insurers to consider bringing third-party actions against parties responsible for the pollution if coverage litigation between an insurer and an insured ensues.

II. POTENTIAL ARGUMENTS THAT CONTAMINATION COMPRISES AN INSURED PERIL

When confronted with a contamination loss, a predictable tension inevitably develops between an insured, who is seeking to realize as much financing as possible from every available source to repair or replace damaged property and to clean up the environmental hazard, and an insurer, who is attempting to limit coverage only to risks it intended to insure under the property insurance policy. It should not be surprising that, from time to time, insureds and insurers adopt conflicting interpretations of the coverage available. To respond effectively, an insurer must understand the bases for the view of coverage adopted by an insured. Policyholders, too, must reasonably comprehend the terms and conditions of their policy and the applicable law governing their claims.

Under standard forms of property insurance,⁶ there are two primary avenues an insured will likely pursue in attempting to recover

⁶ For a succinct review and summary of the development of standard property insurance policy forms in the United States, see R. MEHR & E. CAMMACK, *PRINCIPLES OF INSURANCE* 233-62 (7th ed. 1980) [hereinafter MEHR & CAMMACK]. See also *infra* note 8.

for environmental losses. Under one approach, an insured may seek to recover by alleging that the pollution comprises a peril insured under the policy. Peril in this context means the cause of the loss, and encompasses the risk, hazard, or contingency insured against by the contract of insurance.⁷ Typical perils that can be insured against are fire, hail, smoke damage, explosion, and windstorm, as well as vandalism and malicious mischief.⁸ Policy restrictions such as limitations on the original grant of coverage or exclusions from coverage, however, should be taken into account by an insured and may appropriately be considered by an insurer when responding to a claim.

A second approach to gain coverage is to contend that the affected property and the residue of the contamination constitute "debris" for debris-removal coverage. Most property insurance policies, however, contain provisions requiring that the debris must be made up of covered property, that the loss must be from a peril insured against, and that the total loss to property plus the cost of debris removal must not exceed the amount of insurance.⁹ Further, post-1986 policy forms have limited significantly the scope of debris-removal coverage for pollution-related losses. Possible claims under these two approaches for obtaining property insurance coverage are outlined below.

A. Insured Risk as Proximate Cause of the Loss

The first approach to a recovery for a contamination loss involves alleging a direct physical loss to covered property proximately caused by an insured peril during the policy term. A key aspect of

⁷ See BLACK'S LAW DICTIONARY 1024 (5th ed. 1979); BALLENTINE'S LAW DICTIONARY 934 (3d ed. 1969); see also W. RODDA, PROPERTY AND LIABILITY INSURANCE 2 (1966). Rodda defines "risk," "hazard," and "peril:" "In their insurance usage, the word *hazard* tends to mean something that exposes a property to loss, and a *peril* is the cause of the loss, such as the peril of fire. The uncertainty as to whether a fire will occur." *Id.* (emphasis in original). But see R. KEETON & A. WIDISS, INSURANCE LAW: A GUIDE TO FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES AND COMMERCIAL PRACTICES 10 (1988). Keeton and Widiss note that "[s]ome insurance literature suggests distinctive meanings for the terms 'risk,' 'hazard' and 'peril.' . . . However, there is no commonly accepted standard usage which establishes or recognizes separate and distinct definitions for these terms." *Id.* (footnotes omitted).

⁸ MEHR & CAMMACK, *supra* note 6, at 147-51, 245-47 (in analyzing potential coverage, where the perils are named, their meaning must be defined, the peril must proximately cause the loss, and coverage limitations on the perils must be examined).

⁹ P. THOMAS & P. REED, ADJUSTMENT OF PROPERTY LOSSES 43-44 (4th ed. 1977) [hereinafter THOMAS & REED].

any property policy¹⁰ is the statement of perils insured against, namely, either "risks of direct physical loss" or specific "named perils."

1. All Risk Coverage

Coverage under an all risk policy¹¹ extends to physical loss of, or damage to, property arising from any fortuitous cause, unless specifically excluded.¹² An insured has the burden of proving that the covered property was physically lost or damaged due to a fortuitous

¹⁰ The Insurance Services Office (ISO) is a national organization that has developed standard forms of policies that are used frequently by insurers after having been filed with and approved by the insurance departments of the states in which the coverage is sold. *Id.* at 24. Standard ISO forms of commercial and homeowners property policies include the following: Commercial Policy Forms: IL 00 17 11 85 (Common Policy Conditions); CP 00 90 11 85 (Commercial Property Conditions); CP 00 10 11 85 (Building and Personal Property Coverage Form); CP 10 20 11 85 (Cause of Loss—Broad Form); and CP 10 30 11 85 (Cause of Loss - Special Form). Commercial Lines (Special Multi-Peril Forms): MP 00 90 (Ed. 07 77) (Special Multi-Peril Policy Conditions and Definitions); MP 00 13 (Ed. 10 83) (Special Building Form); and MP 00 14 (Ed. 10 83) (Special Personal Property Form). Personal Lines: HO-3 (Ed. 04 84) (Homeowners Special Form). The Commercial Policy Forms were introduced in approximately 1986 to replace the Commercial Lines, as well as the standard commercial fire forms (i.e., CF 00 13 (Ed. 10 83) (Structures) and CF 00 14 (Ed. 10 83) (Personal Property)). For the most part, the above forms provide all risk coverage. The HO-3, however, provides all risk coverage only on the insured dwelling and structures. It provides named peril coverage for unscheduled personal property. Similarly, the CP 10 20 11 85 provides a named peril coverage for commercial buildings and business personal property. Many of the forms can be found in MALLIN, *supra* note 4, at 139–92. Additional forms can be obtained directly from ISO. Citations will refer only to policy form numbers.

¹¹ Early forms of property policies, other than "named-peril," referred to all risk coverage. Since 1983, however, such property policies have omitted the phrase "all risk" and insure against "risks of direct physical loss." The term "all risk" is generally no longer used in insurance policies. Of course, even when policies were designated as "all risk," they did not cover *every* risk of loss that could possibly befall an insured. Under such coverage, only covered property that was physically damaged due to a fortuitous and nonexcludable event was insured. An insured had the burden of proving it had suffered a covered loss. *See* sources cited *infra* note 13. With these limitations in mind, for ease of reference, this Article will generally refer throughout to all risk coverage in order to distinguish it from named peril coverage.

¹² 13A G. COUCH, R. ANDERSON & M. RHODES, COUCH ON INSURANCE § 48:141 (2d ed. 1982 & Supp. 1989) [hereinafter COUCH ON INSURANCE 2D]; R. OSLER & J. BICKLEY, GLOSSARY OF INSURANCE TERMS (1982). *See, e.g.,* Steamboat Dev. Corp. v. BACJAC Indus., 701 P.2d 127, 128 (Colo. Ct. App. 1985). The court observed:

An "all risk" policy is a special type of coverage extending to risks not usually covered under other insurance, and recovery is allowed thereunder for all losses, other than those resulting from a willful or fraudulent act of the insured, unless the policy contains a specific provision expressly excluding a particular loss from coverage.

Id. For a general review of judicial interpretation and construction of all risk insurance coverage, see Annotation, *Coverage Under "All Risks" Insurance*, 88 A.L.R.2D 1122 (1963).

event.¹³ In evaluating a claim for potential coverage, an insurance company should determine whether one or more specific exclusions apply.¹⁴ Under the following approaches, an insured may argue that a contamination loss is covered under an all risk policy.

a. Third-Party Negligence

One theory on which an insured may rely for coverage is concurrent causation analysis. Application of that doctrine has been developed primarily by the California courts, but also has been applied in various forms in other jurisdictions. As part of the concurrent causation analysis, there will likely be a contention that third-party negligence constitutes an independent peril of loss that is covered. Even though one or more exclusions in an all risk policy may bar coverage for environmental losses, policyholders may adopt the view that there is coverage because the immediate cause of the loss was the negligence of a third person.

A recent decision by the new California Supreme Court,¹⁵ however, has essentially abandoned the concurrent causation doctrine in California in the context of first-party property insurance claims. In *Garvey v. State Farm Fire & Casualty Co.*,¹⁶ the court reinstated a

¹³ See 21 J. APPLEMAN, INSURANCE LAW AND PRACTICE § 12245.25 (1980 & Supp. 1989); 13A COUCH ON INSURANCE 2D § 48:142 (1982 & Supp. 1989); THOMAS & REED, *supra* note 9, at 123-24.

¹⁴ THOMAS & REED, *supra* note 9, at 12.

¹⁵ Since the late 1950's, the California Supreme Court had been generally dominated by jurisprudentially liberal justices. In 1986, however, a highly political campaign was launched to oust from office Chief Justice Rose Bird and Associate Justices Cruz Reynoso and Joseph Grodin. Under California law, all three were up for confirmation re-election to the court that year. Critics excoriated the "liberal Bird Court" for its consistent record of reversing death penalty sentences on automatic appeal and for its pattern of "anti-business" decisions. The three justices were defeated in their bids for re-election.

In the aftermath, California Governor George Deukmejian fashioned a conservative majority on the court. Chief Justice Malcolm M. Lucas was installed and Governor Deukmejian appointed Associate Justices John A. Arguelles, David N. Eagleson, and Marcus M. Kaufman. Holdover jurists remaining on the court were conservative Associate Justice Edward A. Panelli and liberal Associate Justices M. Stanley Mosk and Allen Broussard. Justice Arguelles retired from the court at the conclusion of the Lucas Court's second year. He was replaced by Associate Justice Joyce Kennard, whose appointment was not expected to have a dramatic impact on the outcome of pending cases. See Egelko, *Duke's Court*, CALIF. LAW., June 1987, at 28; Friend, *Rose Bird's Being Run Out of Office—And She Doesn't Seem to Care*, AM. LAW., Sept. 1986, at 335. For an analysis of the track record of decisions established by the Lucas court, see Uelmen, *The Lucas Court: A First-Year Report Card*, CALIF. LAW., June 1988, at 30; Uelmen, *Mainstream Justice: A Review of the Second Year of the Lucas Court*, CALIF. LAW., July 1989, at 36.

¹⁶ 770 P.2d 704, 257 Cal. Rptr. 292 (1989). The *Garvey* court reached its decision by a five-to-two vote. Justices Panelli, Eagleson and Arguelles joined with Chief Justice Lucas in the majority opinion. Justice Kaufman, joined by Justice Panelli, offered a concurring opinion in

more traditional form of proximate cause analysis in place of concurrent causation analysis. Following the established doctrine of California, the trial court in *Garvey* ruled that a homeowner's insurer that issued an all risk policy would be liable to its insured for damage resulting from concurrent causes if *either* of the causes was a covered peril.¹⁷

The trial court in *Garvey* directed a verdict against the insurance company because there was evidence that negligent construction, considered a covered peril in California, was at least a partial cause in damaging the insured's home. The jury then returned a verdict that included one million dollars in punitive damages.¹⁸ The California Supreme Court affirmed the decision of the Court of Appeal to reverse the trial court. The action was remanded for a new trial to allow the jury to resolve the causation issue as a question of fact.¹⁹

The *Garvey* decision reflected the first time the California Supreme Court had considered the concurrent causation doctrine in an insurance context since 1973. In *Garvey*, the court articulated a standard of causation for first-party property cases for the first time since 1963 as it rejected application of the concurrent causation doctrine in first-party claims. The court revived a test originally articulated by an earlier California Supreme Court in *Sabella v. Wisler*.²⁰ After

which he suggested that concurrent causation should not even be applied in determining coverage under liability insurance policies. Justices Mosk and Broussard each authored spirited dissents.

¹⁷ 770 P.2d at 706, 257 Cal. Rptr. at 294.

¹⁸ *Id.*

¹⁹ *Id.* at 715, 257 Cal. Rptr. at 303. The *Garvey* decision did not hold that coverage for the insurance claim before it was automatically excluded. The majority remanded the case for retrial and a determination of coverage under a proximate cause standard. The court expressly noted that its decision would not "automatically produce a victory for the insurer." *Id.* at 714 n.11, 257 Cal. Rptr. at 302 n.11. The court explained: "Indeed, a reasonable juror could find that under the facts of this case, negligent construction [a covered peril] was the predominant cause of the property damage. In any event, the ultimate coverage determination is for the jury." *Id.*

²⁰ 59 Cal. 2d 21, 377 P.2d 889, 27 Cal. Rptr. 689 (1963). In *Sabella*, the insureds sought coverage under their "all physical loss" homeowners policy for damage to their house caused by earth subsidence and extensive settling caused by a leak in a sewer pipe. The applicable policy excluded coverage for losses caused by "settling." In ruling on the property damage claim, the court concluded that the settling exclusion did not apply. There was insurance coverage because the ruptured sewer pipe that leaked, rather than settling, was the efficient proximate cause of the loss. *Id.* at 24-26, 30-32, 377 P.2d at 890-92, 894-95, 27 Cal. Rptr. at 690-92, 694-95. The *Sabella* court explained:

"[I]n determining whether a loss is within an exception in a policy, where there is a concurrence of different causes, the efficient cause—the one that sets others in motion—is the cause to which the loss is to be attributed, though the other causes may follow it, and operate more immediately in producing the disaster."

Id. at 31-32, 377 P.2d at 895, 27 Cal. Rptr. at 695 (quoting 6 COUCH ON INSURANCE § 1466, at 5298 (1930)).

Garvey, the California standard of causation in first-party property insurance claims requires a finding that an insured risk is the "efficient proximate cause" of the insured's loss.²¹

The court distinguished the principles for determining coverage for damage to property under a first-party policy, insured versus insurer, from the applicable rules for tort liability coverage under a third-party liability insurance policy, third-party claimant versus insured, defended by insurer.²² Chief Justice Lucas, writing for the majority, criticized the application of the concurrent causation doctrine articulated for tort liability coverage in first-party property insurance claims.²³ In *Garvey*, the court clarified that the concurrent causation doctrine established by the California Supreme Court for tort liability coverage in *State Farm Mutual Automobile Insurance Co. v. Partridge*²⁴ does not apply in the context of first-party claims.

²¹ 770 P.2d at 714-15, 257 Cal. Rptr. at 302-03. The causation standard for coverage under property insurance in California after *Garvey* is focused on the "predominating cause," not the "moving cause" or "triggering event." *Id.* at 708, 257 Cal. Rptr. at 296. *See, e.g.,* Mission Nat'l Ins. Co. v. Coachella Valley Water Dist., 258 Cal. Rptr. 639, 645 (Ct. App. 1989) (where jury instruction defined "efficient proximate cause" as "the cause that sets the others in motion," the trial court instruction was erroneous because it suggested that the jury should focus on the "triggering cause" rather than the "predominating cause").

²² In declining to approve the extension of tort liability insurance analysis to the first-party insurance case before it, the court observed:

[T]he distinction between first- and third-party claims can be summarized as follows: if the insured is seeking coverage against *loss or damage sustained by the insured*, the claim is first party in nature. If the insured is seeking coverage against *liability of the insured to another*, the claim is third party in nature.

770 P.2d at 705 n.2, 257 Cal. Rptr. at 293 n.2 (emphasis in original).

²³ *Id.* at 709-11, 257 Cal. Rptr. at 297-99; *see also* Prudential-LMI Commercial Ins. Co. v. Superior Court, 260 Cal. Rptr. 85, 90 (Ct. App. 1989) (acknowledging that in *Garvey* the California Supreme Court distinguished first-party causation analysis from that applied under third-party liability policies) (the *Prudential-LMI* case is of interest for discussion purposes only because, pending review by the California Supreme Court, the decision by the Court of Appeal has no precedential value and may not be cited as authority), *review granted*, Sept. 21, 1989.

²⁴ 10 Cal. 3d 94, 514 P.2d 123, 109 Cal. Rptr. 811 (1973). In *Garvey*, the majority noted that *Partridge* addressed causation in a third-party liability context but that it did not consider how concurrent causation could apply in the first-party property insurance context. In *Partridge*, the court considered whether two negligent acts of the insured, constituting concurrent causes of an accident, triggered coverage under both the insured's homeowners policy and automobile liability policy or whether coverage was limited to the liability policy. The insured was sued by a passenger who had been injured while riding in the insured's vehicle, driven by the insured. The insured driver drove off a paved highway in pursuit of a fleeing jackrabbit while holding a gun that he had modified to create a "hair trigger action." The gun accidentally discharged when the vehicle hit a bump, and the passenger was seriously injured. *Id.* at 96-98, 514 P.2d at 124-26, 109 Cal. Rptr. at 812-14. The homeowners policy expressly excluded coverage for "bodily injury . . . arising out of the . . . use of . . . any motor vehicle." *Id.* at 99, 514 P.2d at 126, 109 Cal. Rptr. at 814. The insurer, which issued both policies, contended

The court cautioned that the application of a *Partridge* concurrent causation approach to coverage in first-party claims would essentially nullify the specific exclusions contained in all risk policies, and would abrogate the terms limiting the grant of coverage provided under all risk property insurance.²⁵ Such a result would ignore the terms and conditions of the all risk policy and, therefore, would be unacceptable. The California Supreme Court restricted the application of concurrent causation analysis only to coverage questions under policies protecting the insured against liability claims by third parties.²⁶

Additionally, the *Garvey* court continued to recognize that, in California, negligence constitutes an independent peril covered under first-party property insurance.²⁷ The majority, however, acknowledged that distinctions between types of negligence may be valid for determining coverage. Without addressing the question, the court left open the possibility that coverage may not exist for negligent acts undertaken "for the sole purpose"²⁸ of protecting against an excluded risk. The court also declined to comment on whether it would enforce new policy language specifically excluding third-party negligence as a covered peril.²⁹

that only the automobile policy provided coverage. The trial court found that the insured had been negligent both in modifying the trigger mechanism of the gun and in driving his vehicle off the paved road onto the rough terrain. It then concluded that both policies applied to the accident and that the injured third-party claimant was entitled to recover under both. *Id.* at 100-01, 514 P.2d at 127, 109 Cal. Rptr. at 814.

²⁵ The court's criticism of the extension of the analysis in *Partridge* to first-party property claims is well summarized by the majority at the beginning of the *Garvey* opinion. 770 P.2d at 705, 257 Cal. Rptr. at 293; see also *Prudential-LMI*, 260 Cal. Rptr. at 90 (Ct. App. 1989) (reiterating that in *Garvey* the California Supreme Court concluded that the policyholder and the insurance company could not reasonably expect coverage for a property loss where the efficient proximate cause of the loss was a peril expressly excluded by the terms and conditions of the policy).

²⁶ 770 P.2d at 705, 257 Cal. Rptr. at 293.

²⁷ *Id.* at 711-12, 257 Cal. Rptr. at 299-300.

²⁸ The California Supreme Court observed that it may be important for courts to distinguish between types of negligence when determining whether there is coverage for negligent acts under property policies. The court stated that when the issue is raised future courts might recognize that there should be no coverage for negligent acts undertaken for the sole purpose of protecting insured premises against risks specifically excluded under a policy. *Id.* at 712 n.7, 257 Cal. Rptr. at 300 n.7.

²⁹ The California Supreme Court did not discuss the effect of the new "anti-concurrent cause" policy exclusions that specifically exclude third-party negligence. The majority opinion stated that "[b]ecause the effect of the new language is unclear, we refer only to pre-1983 policies in our explanation of liability and property insurance coverage on the principles applicable to such policies." *Id.* at 710 n.6, 257 Cal. Rptr. at 299 n.6.

For a general discussion of the revised policy language adopted by insurers in response to the concurrent causation doctrine, see Bragg, *Concurrent Causation and the Art of Policy Drafting: New Perils for Property Insurers*, 20 FORUM 385 (1985). The reaction of the courts

It remains to be seen whether other states that have adopted some form of concurrent causation analysis will follow California's lead in repudiating the doctrine in first-party property claims. *Raybestos-Manhattan, Inc. v. Industrial Risk Insurers*³⁰ is a case in which the court was persuaded that the negligent act of a third party was covered under an all risk policy, even though the loss resulted from contamination, an excluded peril. A tank truck driver unintentionally poured an entire load of fuel oil into the insured's underground heptane tank at the insured's industrial storage facility. The fuel mixed with the heptane. The mixture was fed into an auxiliary tank used for production purposes and damaged the insured's work in progress.³¹

The policy at issue provided coverage "against all risks of direct physical loss or damage from *any external cause* to the insured property, except as hereinafter excluded."³² The policy then excluded losses "caused by or resulting from . . . *contamination . . . unless such loss is caused directly by physical damage to the property covered, or to premises containing such property, by a peril not excluded in this policy.*"³³ The trial court concluded that coverage existed for the loss under these policy terms and entered judgment in the insured's favor.³⁴ The insurer appealed.

On appeal the court found that, under "any reasonable definition," the damage to the insured's work in progress was "caused by con-

to the new policy forms has been mixed. There are only a few cases at the appellate level addressing the redrafted policy language. Several courts, however, have enforced the revised language and declined to grant coverage for third-party negligence based on a concurrent causation analysis. *See, e.g., State Farm Fire & Cas. Co. v. Martin*, 872 F.2d 319, 321 (9th Cir. 1989) (applying California law) (the concurrent causation exclusion was unambiguous and did not violate the California Insurance Code); *Kane v. Royal Ins. Co. of Am.*, 768 P.2d 678, 685 (Colo. 1989) (the "efficient moving cause" rule must yield to the language of the insurance policy); *Tzung v. State Farm*, 873 F.2d 1338 (9th Cir. 1989) (applying California law) (under policy provisions excluding coverage for faulty workmanship and inherent defects, there was no coverage for losses caused by third-party negligence in the design and construction of the insured's apartment building); *Mission Nat'l Ins. Co. v. Coachella Valley Water Dist.*, 258 Cal. Rptr. 639, 646 (Ct. App. 1989) (citing with approval *State Farm v. Martin*); *State Farm Fire & Cas. Co. v. Paulson*, 756 P.2d 764, 766 (Wyo. 1988) (flood exclusion was unambiguous and the insured's claim for damage to his home that resulted from the entrance of water and hail into his basement after a severe storm was excluded). The Washington Supreme Court, however, has refused to enforce the revised exclusionary language. *See Safeco Ins. Co. of Am. v. Hirschmann*, 112 Wash. 2d 621, 629, 773 P.2d 413, 416 (1989) (ruling that, as a matter of public policy, the insurer was not permitted to "circumvent" the "efficient proximate cause" rule by use of its exclusionary clause).

³⁰ 289 Pa. Super. 479, 433 A.2d 906 (1981).

³¹ *Id.* at 481, 433 A.2d at 907.

³² *Id.* (emphasis supplied by the court).

³³ *Id.* (emphasis supplied by the court).

³⁴ *Id.*

tamination.”³⁵ This finding reflected that the heptane-fuel mixture came into contact with the insured’s work in progress and rendered it worthless. The court, however, did not enforce the contamination exclusion to bar coverage.³⁶ Rather, the court was persuaded that the proximate cause of the insured’s loss was the unintentional pouring of fuel oil into a tank intended for heptane, in other words third-party negligence.³⁷ The court reasoned that coverage for loss or damage caused by, or resulting from, the negligent acts of a third person was not excluded by the policy.³⁸ Relying on the express policy language, the court ruled that coverage existed because the contamination loss was caused by a nonexcluded external peril.³⁹ The appellate court affirmed the trial court’s judgment in favor of the insured.⁴⁰

b. Contamination Characterized as a Nonexcluded Peril

To overcome a defense based on the contamination exclusion, insureds may characterize the cause of loss as some peril other than contamination. In *Insurance Co. of St. Louis v. McConnell Construction Co.*,⁴¹ a loss was found to have been caused by corrosion, a covered peril, rather than by contamination, an excluded peril.

³⁵ *Id.* at 482, 433 A.2d at 908.

³⁶ *Id.*

³⁷ *Id.* at 482–83, 433 A.2d at 908.

³⁸ *Id.*

³⁹ *Id.* at 489, 433 A.2d at 908–09.

⁴⁰ *Id.* at 484, 433 A.2d at 909. In so holding, the court reasoned: “[T]he policy provided coverage even though the external cause brought about the loss by contaminating the contents of the heptane tank used for work in progress.” *Id.* But see *American Casualty Co. v. A.L. Myrick*, 304 F.2d 179, 184 (5th Cir. 1962), in which the court declined to employ a similar theory. The policy covered “all risks of direct physical loss or damage to the insured property from an external cause . . . except as hereinafter excluded.” *Id.* at 181. The insured sought recovery for damage to foodstuffs made unfit for human consumption because of contact with ammonia gas. The court enforced the contamination exclusion and rejected the insured’s argument that coverage should be found as if the contamination exclusion were not in the contract. *Id.* at 184. The Fifth Circuit Court of Appeals refused to adopt the insured’s position that ammonia gas was an external cause of the loss for which the exclusion did not apply. *Id.* at 183–89; see also *Falcon Products v. Insurance Co. of the State of Pa.*, 615 F. Supp. 37 (E.D. Mo. 1985), *aff’d*, 782 F.2d 779 (8th Cir. 1986). The insured purchased irradiated metal which was contaminated before the insured received ownership of the property. *Falcon Products*, 615 F. Supp. at 38. In order to surmount the argument that the contamination exclusion barred recovery, the insured argued that the efficient physical cause of the loss was third-party negligence of the person(s) responsible for contaminating the metal. *Id.* at 39. The court did not rely upon the insured’s arguments to resolve the case. Instead, it decided the case on the grounds that the insured had no insurable interest in the property because the property was not “covered” under the applicable policy. *Id.* Coverage was also denied because of the contamination exclusion. *Id.*

⁴¹ 419 S.W.2d 867 (Tex. Civ. App. 1967), *rev’d*, 428 S.W.2d 659 (Tex. 1968).

The insured building contractor sued to recover under a builders risk policy insuring against "all risks of physical loss to . . . described dwelling(s), building(s), or structure(s)." ⁴²

The *McConnell* trial court granted recovery for damage resulting from the application of muriatic acid to brick flooring in a newly constructed house. ⁴³ The builder applied the muriatic acid in an effort to clean the floor, shortly before conveying the house to a new owner. The acid reacted with mortar in the brick to produce a wet gas highly corrosive to metal. Severe discoloration and the appearance of "pit marks" on the interior metal surfaces occurred. ⁴⁴ A chemist testified that the fumes from the muriatic acid corroded the metal objects inside the house. ⁴⁵ The insurer defended by arguing that the loss was excluded because it was caused by contamination. ⁴⁶ The Houston Court of Civil Appeals examined the evidence and concluded that, as a matter of law, the loss was due to contamination. ⁴⁷ The appellate court ruled that coverage was precluded by a policy provision excluding "loss by contamination including loss by radioactive or fissionable materials." ⁴⁸

The Texas Supreme Court, distinguishing between contamination and corrosion, reversed the intermediate appellate court. ⁴⁹ Accord-

⁴² 428 S.W.2d at 659.

⁴³ *Id.* at 660.

⁴⁴ 419 S.W.2d at 868.

⁴⁵ *Id.*

⁴⁶ *Id.* at 869. Property insurers must be prepared to produce expert testimony, if necessary, establishing contamination as the cause of the loss. Butler, *supra* note 4, at 372. In *McConnell*, the Texas Supreme Court noted that there was no evidence in the record disputing the testimony of the insured's expert and explained:

The insurance company called no witnesses in this case. The evidence as to the causes and factors which resulted in the corrosion of the metal parts of the house is undisputed and not subject to divergent or conflicting inferences. There was no occasion for giving the insurance company's requested instruction or definition relating to "contamination." There being no dispute in the facts, the question of whether the corrosion which occurred came within the contamination exclusion was not a jury issue in this case.

428 S.W.2d at 662. In *Auten v. Employers National Insurance Co.*, 722 S.W.2d 468 (Tex. Ct. App. 1986), *writ denied*, 749 S.W.2d 497 (Tex. 1988), the Texas Court of Appeals reversed the trial court and ruled as a matter of law that coverage for the insured's losses was excluded because they were due to contamination. *Id.* at 471. The insureds sued their insurer to recover for losses that resulted when a professional exterminator misapplied the pesticide Dursban in their home. *Id.* at 468-69. By relying on the testimony of expert chemists, the court found that the excessive release of the pesticide inside the insureds' house rendered the dwelling "impure" and constituted contamination. *Id.* at 469-70; *see also infra* note 68.

⁴⁷ *Insurance Co. of St. Louis*, 419 S.W.2d at 869.

⁴⁸ *Id.* at 869-70.

⁴⁹ *McConnell*, 428 S.W.2d at 663.

ing to the court, the loss resulted from corrosion, which was not excluded as contamination. The court based its ruling on the expert's testimony and on dictionary distinctions between contamination and corrosion.⁵⁰ Although the court acknowledged that certain instances of corrosion might be classified as contamination,⁵¹ the facts before it established no blending of substances which resulted in an impure mixture.⁵²

2. Named Peril Coverage

Under named peril coverage, insurance applies only to certain risks specified in a policy. An insured has the burden of proving that its loss arose from one of the named perils.⁵³ In evaluating a claim, an insurance company must determine whether one of the specified perils caused a direct loss to covered property.⁵⁴ Under the following circumstances, insureds may argue that contamination losses constitute a covered peril within a specified risk policy.

a. Fire

A fire may cause the release of contaminants affecting covered property.⁵⁵ An insured may assert that coverage exists for such

⁵⁰ *Id.* at 660-61.

⁵¹ *Id.* at 661. In *McConnell*, the Texas Supreme Court found no basis in the record to support a finding that contamination caused the loss and held:

The connotation of contamination is a mixing of substances like dirt and water which results in an impure mixture. Corrosion on the other hand connotes disintegration, oxidation, decay of metal and the like. While it may be possible that under certain situations, a corrosion may also be classified as a contamination, that is not the situation here. We have no mixing of substances resulting in impurity . . . We hold that the loss in this case was comprehended by the insuring clause of the policy and was not excluded therefrom.

Id.

⁵² *Id.* The Texas Supreme Court in *McConnell* did not acknowledge or discuss the "unfit for use" approach to define "contamination," recognized in *Hi-G, Inc. v. St. Paul Fire & Marine Insurance Co.*, 283 F. Supp. 211, 213 (D. Mass. 1967), *aff'd*, 391 F.2d 924 (1st Cir. 1968).

⁵³ *Reed v. Commercial Ins. Co.*, 248 Or. 152, 155-56, 432 P.2d 691, 693 (1967). *See, e.g.*, *American Produce & Vegetable Co. v. Phoenix Assur. Co. of N.Y.*, 408 S.W.2d 954 (Tex. Civ. App. 1966). Where it was undisputed that damage to the insured's food in storage was caused by leaking ammonia, the insured could not recover under a policy excluding losses due to "contamination . . . unless such loss or damage is caused directly by . . . bursting of pipes or apparatus" because the insured failed to prove by a preponderance of the evidence that the loss was caused by the bursting of an apparatus. *Id.* at 955-56.

⁵⁴ THOMAS & REED, *supra* note 9, at 123.

⁵⁵ In order to constitute a fire within the coverage of a standard fire policy, a majority of cases holds that "there must be some visible indication of fire such as flame, glow, or light." *Washington State Hop Producers, Inc. v. Harbor Ins. Co.*, 34 Wash. App. 257, 259, 660 P.2d

contamination losses under the peril of fire.⁵⁶ In *Marshall Produce Co. v. St. Paul Fire & Marine Insurance Co.*,⁵⁷ a contamination loss was covered as damage by fire. The relevant policies covered the insured's egg and milk processing plant against "all loss or damage by fire originating from any cause."⁵⁸ As the result of a nearby house fire, the insured's manufacturing plant was saturated with a dense blue-gray smoke.⁵⁹

Under a contract with the federal government, the insured was required to supply powdered milk and eggs, which were processed under stringent sanitation requirements.⁶⁰ Although there was no proven damage to the insured's egg powder, the cans and wrappers

768, 769 (1983). A mere showing by an insured of "the emission of smoke, steam or heat is not sufficient to establish the existence of a fire." Annotation, *Loss by Heat, Smoke, or Soot Without External Ignition as Within Standard Fire Insurance Policy*, 17 A.L.R.3d 1155 (1968 and Supp. 1989). When the word "fire" is not defined within the policy, some courts interpret the word according to its ordinary or popular meaning. An accepted definition states that fire means "the phenomenon of combustion as manifested in light, flame, and heat." *Washington State Hop Producers*, 34 Wash. App. at 255, 660 P.2d at 769 (quoting WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 854 (1976)). See, e.g., *Hartford Fire Ins. Co. v. Electrical Dist. No. 4*, 452 P.2d 539, 542-43 (Ariz. Ct. App. 1969) (damage to transformer from overheating of copper wiring resulting from a short circuit without ignition or flames was not covered by fire policy); *Washington State Hop Producers*, 34 Wash. App. at 258-59, 660 P.2d at 768-69 (no coverage under fire policy for damage to baled hops by browning or charring due to heat when there was no evidence of any flame or glow in the damaged crops).

⁵⁶ Fire insurance policies, however, are intended to protect only against losses resulting from "hostile fires" and do not provide coverage for losses due to "friendly fires." See 5 J. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 3082 (1970 and Supp. 1988); 10A COUCH ON *INSURANCE* 2D §§ 42.13-.15 (1982 & Supp. 1988); MEHR & CAMMACK, *supra* note 8, at 150. When the loss-inducing contaminant is released through some industrial process involving a fire set intentionally and utilized by an insured in its business, an insurance company should consider whether the cause of loss constitutes a friendly fire, for which there is no coverage. The term "friendly fire" is usually defined to mean a fire set by an insured for a manufacturing-related purpose that remains confined in a furnace, incinerator, or other ordinary place intended by an insured for the fire, although damage may result where none was intended. See, e.g., *Youse v. Employers Fire Ins. Co.*, 172 Kan. 111, 113-15, 238 P.2d 472, 474-76 (1951).

The friendly fire doctrine remains a valid basis for a defense where the facts so direct, but some recent decisions have followed a liberal trend and have construed the doctrine somewhat narrowly. See, e.g., *Schulze and Burch Biscuit Co. v. American Protection Ins. Co.*, 96 Ill. App. 3d 350, 421 N.E.2d 331 (1981) (unanticipated loss was covered, notwithstanding friendly/hostile dichotomy of fire insurance law, when an oven used in the insured's baking business was inadvertently left to operate with no product to absorb heat and the temperature rose in excess of the normal temperature inside the oven).

⁵⁷ 256 Minn. 404, 98 N.W.2d 280 (1959); see also *St. Paul Fire & Marine Ins. Co. v. Protection Mut. Ins. Co.*, 664 F. Supp. 323, 335 (N.D. Ill. 1987) (there was coverage under an all risk property policy for the expenses of cleaning up PCB contamination at the insured's manufacturing plant because the release of PCBs was directly attributable to a fire).

⁵⁸ 256 Minn. at 409, 98 N.W.2d at 285.

⁵⁹ *Id.* at 407, 98 N.W.2d at 284.

⁶⁰ *Id.* at 408, 98 N.W.2d at 284-85.

in which the products were packaged were damaged by the smoke. When the federal government subsequently rejected the insured's products because of smoke damage to the cans and wrappers,⁶¹ a covered loss was found to have taken place.⁶²

The court held that it was not necessary for coverage that any part of the insured's property must actually have ignited.⁶³ Nor was it necessary that the fire must have occurred within the insured's building for coverage to exist.⁶⁴ Under Minnesota law, the fire policy covered losses proximately resulting from fire, even though the fire itself did no injury to the objects insured.⁶⁵

The *Marshall Produce* case, however, should offer only limited support for claiming coverage of contamination losses under the peril of fire. Under the "Minnesota form" of standard insurance policy, there was no requirement that the fire had to be a *direct* cause of the loss or damage, as was the case with the "New York form."⁶⁶ The insured, therefore, was entitled to recover for a loss in value to insured goods, for which a showing of physical damage to the property was not necessary.⁶⁷

b. *Smoke*

Insureds may contend that a contamination loss is covered under the smoke peril.⁶⁸ Coverage for damage due to smoke is usually

⁶¹ *Id.* at 428-29, 98 N.W.2d at 297.

⁶² *Id.* at 434, 98 N.W.2d at 300.

⁶³ *Id.* at 415, 98 N.W.2d at 289.

⁶⁴ *Id.*

⁶⁵ *Id.* The court held that the loss was covered as "damage by fire" because:

Whatever the loss may have been, it is obvious that the fire was the proximate cause of the loss; that smoke and its resulting foul odors spread into the plant and its contents, which led the government officials to do what they might well be expected to do under the prevailing conditions; namely, to reject the merchandise and render the same valueless.

Id. at 418, 98 N.W.2d at 290.

⁶⁶ *Id.*, 98 N.W.2d at 290-91.

⁶⁷ *Id.* at 414-15, 98 N.W.2d at 288-89.

⁶⁸ See, e.g., Wall Street Journal, Nov. 24, 1989, at 2B, col. 1. The article describes a recent Oregon trial court ruling that required an insurer to pay for cleaning up a residence contaminated by an illegal drug manufacturing lab because the resulting damage was caused by "smoke" from the drug-cooking process. Relying on the contamination exclusion in the applicable policy, the insurer denied coverage for damage due to the chemical contaminants. Nevertheless, the expert hired by the insurer testified that he "couldn't exclude smoke" as a cause of the damage. *Id.* The court declined to enforce the contamination exclusion to bar coverage and concluded that the relevant contamination provision did not exclude coverage for smoke damage. *Id.* The ruling is believed to be the first of its kind in the United States. No appeal was filed.

The insureds rented their recreational rental home for one week to a tenant who, unknown to the owners, used the property to manufacture the illegal drug methamphetamine, also

limited in standard policy forms to "sudden and accidental damage from smoke, other than smoke from agricultural smudging or industrial operations."⁶⁹ Under such coverage the word "sudden" should exclude damage occurring over a long period of time.⁷⁰ In *Henri's Food Products Co. v. Home Insurance Co.*,⁷¹ however, a chemical vapor that contaminated the insured's edible goods constituted smoke within the coverage of a standard fire policy.⁷² The vapor escaped from agricultural chemicals stored in a warehouse and left a residue on the insured's packaged products.⁷³ The policy covered the insured's goods stored at a warehouse against direct loss by smoke.⁷⁴

The court consulted both dictionary and judicial definitions of "vapor" and "smoke" and applied its own understanding of the terms.⁷⁵ Ruling in favor of the insured, it concluded that the chemical vapor constituted smoke within the coverage for that peril.⁷⁶ The court held that a loss occurred when the Food and Drug Administration seized the insured's packaged products. Because the loss fell within the coverage for smoke damage, the court did not find it necessary to address coverage under the all risk coverage endorsement.⁷⁷

c. *Vandalism and Malicious Mischief*

An insured may also contend that contamination losses should be covered as vandalism or malicious mischief,⁷⁸ a risk that is usually included under named peril policies. To recover under this peril, an insured ordinarily must prove wanton or malicious acts intended by

known as "meth," "crank," or "crystal." The substance requires somewhat readily obtainable ingredients and is "cooked up" in a relatively simple process. *Id.* A building where the drug has been manufactured becomes impregnated with a "sickly sweet" odor and with chemical residue from the vapors of the cooking that must be removed before the residence is habitable again. *Id.*; see also NAT'L UNDERWRITER, Dec. 11, 1989, at 2.

⁶⁹ MEHR & CAMMACK, *supra* note 8, at 246.

⁷⁰ *Id.*; THOMAS & REED, *supra* note 9, at 115.

⁷¹ 474 F. Supp. 889 (E.D. Wis. 1979).

⁷² *Id.* at 893.

⁷³ *Id.*

⁷⁴ *Id.* at 892.

⁷⁵ *Id.* at 893.

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ A collection of cases discussing the question of what constitutes "vandalism" or "malicious mischief" for property insurance coverage is set forth in Annotation, *What Constitutes "Vandalism" or "Malicious Mischief" Within Coverage of Property Insurance Policy*, 23 A.L.R.3D 1259 (1969 and Supp. 1989).

the perpetrator to damage or destroy property.⁷⁹ Although a minority of jurisdictions require proof of personal animosity toward the insured or subjective intent to damage the described property to establish malice,⁸⁰ the growing trend, and present majority position, is that malice may be inferred from an unlawful act.⁸¹ The term "vandalism" also has been extended by its popular meaning to comprise unusual destruction of property resulting from the completion of a wrongful act.⁸²

In *Louisville and Jefferson County Metropolitan Sewer District v. Travelers Insurance Co.*,⁸³ the court found coverage for a contamination loss by characterizing it as having been caused through vandalism and malicious mischief.⁸⁴ The insured, a metropolitan sewer district, carried property insurance on its wastewater treatment

⁷⁹ 13A COUCH ON INSURANCE 2D § 48:210 (1983 & Supp. 1988).

⁸⁰ See, e.g., *Imperial Cas. and Indem. Co. v. Terry*, 451 S.W.2d 303 (Tex. Civ. App. 1970). There was no evidence that damage to the motor of an insured vehicle was the result of malicious mischief, and the court ruled: "Regardless of how careless, negligent or even illegal an act might be, it is not malicious mischief absent evidence that the act was motivated by malice towards the property or its owner, i.e., by fixed intent to cause injury to specific property." *Id.* at 305.

⁸¹ See, e.g., *Hatley v. Truck Ins. Exch.*, 261 Or. 606, 616, 494 P.2d 426, 431 (1972) ("We think property has been damaged 'willfully and maliciously' if the damage results from an intentional act from which damage manifestly would or could result."); *Romanych v. Liverpool & London & Globe Ins. Co.*, 8 Misc. 2d 269, 167 N.Y.S.2d 398 (1957). The *Romanych* court held that: "Malice does not necessarily mean hatred. It may be inferred from unjustifiable conduct. In a legal sense, it means a wrongful act, done intentionally, without just cause or excuse." *Id.* at 272, 167 N.Y.S.2d at 401.

⁸² See, e.g., *King v. North River Ins. Co.*, 278 S.C. 411, 413, 297 S.E.2d 637, 638 (1982) ("The legal malice necessary to establish vandalism within the meaning of [a comprehensive fire insurance] policy need not amount to ill will or vindictiveness of purpose but is sufficient if the destruction was in conscious or intentional disregard of the rights of another.") Even under the majority view, the vandalism or malicious mischief must have been perpetrated by a human actor. *Roselli v. Royal Ins. Co. of Am.*, 142 Misc. 2d 857, 858, 538 N.Y.S.2d 898, 899 (1989) (no coverage for damage to personal property caused when a deer entered the insured's apartment).

⁸³ 753 F.2d 533 (6th Cir. 1985). But see *Swedberg v. Battle Creek Mut. Ins. Co.*, 218 Neb. 447, 356 N.W.2d 456 (1984). There was no coverage under the vandalism and malicious mischief provision of a property insurance policy for the death of cattle by poisoning. The cattle ingested a poisonous substance containing chlorate that had been dumped by unknown persons on land rented by the insured for the purpose of grazing his cattle. Abandoned machinery and other debris, as well as molasses and oats, had also been dumped on the ground in the area of the poison. The court ruled that coverage under the vandalism and malicious mischief insurance required a showing that the party responsible for dumping the poison intended to damage the insured property (i.e., kill the livestock). The fact that the dumping of the poisonous chloride was done willfully or deliberately failed to establish "malice" for coverage. The Nebraska Supreme Court, therefore, ruled that the trial court had erred in finding coverage. *Id.* at 451-54, 356 N.W.2d at 460-61.

⁸⁴ 753 F.2d at 537-38.

plant. The policy provided coverage for "direct loss by: vandalism and malicious mischief, meaning only direct loss by willful and malicious damage to or destruction of property."⁸⁵ A third party dumped large quantities of toxic waste material into the municipal sewer system.⁸⁶ The dumping was in violation of state and federal law and resulted in severe damage to the insured's primary wastewater treatment facility.⁸⁷

The Sixth Circuit Court of Appeals upheld the insurer's liability under the policy, and affirmed the district court's ruling to that effect.⁸⁸ Before the district court, the parties had stipulated that the act of dumping the toxic substances into the sewer system was unlawful and that it had caused damage to the insured's property.⁸⁹ Evidence further established that the third party had removed a 128-pound manhole cover in order to dump the toxic waste material.⁹⁰ He then filled the manhole with sand and dirt to hide the dumping.⁹¹ The court of appeals found that the third party willfully performed the unlawful act under conditions that obviously would lead to property damage.⁹²

Applying Kentucky law, the court held that the unlawful act itself provided the requisite malice for coverage under the pertinent vandalism and malicious mischief provision.⁹³ There was no requirement that the act had to be performed out of personal animosity toward the property owner for coverage to arise.⁹⁴ The court held the property insurer liable for the insured's unrecouped damages.⁹⁵ It also charged the insurer a pro rata portion of the insured's litigation expenses in prosecuting a claim for damages against certain third-party tortfeasors.⁹⁶

d. Explosion

Finally, contamination losses may allegedly arise from an explosion, if explosion is a peril covered under the policy. Although there

⁸⁵ *Id.* at 534-35.

⁸⁶ *Id.* at 535.

⁸⁷ *Id.*

⁸⁸ *Id.* at 538.

⁸⁹ *Id.* at 535.

⁹⁰ *Id.*

⁹¹ *Id.* at 535-36.

⁹² *Id.* at 537-38.

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.* at 538.

⁹⁶ *Id.* at 540.

is no reported decision awarding coverage for a contamination loss under the peril of explosion, a case related to this issue is *American Alliance Insurance Co. v. Keleket X-Ray Corp.*⁹⁷ Under a policy providing coverage for expenses incurred to reduce the insured's business interruption loss, the Sixth Circuit Court of Appeals disallowed an award of expenses to decontaminate a building.⁹⁸

The insured manufactured a pocket-sized device for measuring exposure to radiation. As part of the manufacturing process, a calibration procedure was used to determine the accuracy of the instrument.⁹⁹ One of the insured's physicists, while conducting routine calibration operations, heard a "pop" sound.¹⁰⁰ He also observed the emission of a finely powdered radium salt from the calibration stand in which the known radium source was stored.¹⁰¹ The radioactive powder and radon gas¹⁰² permeated the insured's manufacturing plant, contaminating it with radiation.¹⁰³ Large quantities of stock and other material became contaminated, all of which was unsalvageable.¹⁰⁴ The insured's manufacturing operation was interrupted for a five-month period.¹⁰⁵

The trial court addressed whether the accident constituted an explosion for coverage purposes. None of the policies before the court covered the building against damage due to explosion.¹⁰⁶ Insurance companies had issued stock policies and business interruption policies, however, insuring against direct loss to stock, materials, and supplies by explosion and loss of gross earnings resulting directly from the necessary interruption of business caused by explosion.¹⁰⁷ The jury returned a verdict finding that there had been an explosion of the radium source located in the insured's plant, and, therefore, found the insurers liable.¹⁰⁸

The Sixth Circuit Court of Appeals affirmed the verdict.¹⁰⁹ Even though the explosion was of a small magnitude, the court was per-

⁹⁷ 248 F.2d 920 (6th Cir. 1957).

⁹⁸ *Id.* at 930-31.

⁹⁹ *Id.* at 922-23.

¹⁰⁰ *Id.* at 923.

¹⁰¹ *Id.*

¹⁰² Radon gas is a "highly radioactive decay product of radium." *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Id.* at 922.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.* at 930.

¹⁰⁷ *Id.* at 922.

¹⁰⁸ *Id.*

¹⁰⁹ *Id.* at 923.

suaed that there was substantial evidence from which the jury reasonably could have inferred that an explosion had taken place.¹¹⁰ This evidence included a buildup of gas pressure within the capsule, the occurrence of a "popping noise," and the emission of a cloud of powder.¹¹¹ The court recognized that it was impossible to establish a hard and fast definition of the word "explosion" that would satisfy all factual contingencies.¹¹² Although the finding of an explosion was upheld, as well as the reimbursements for losses to stock and lost earnings, the Sixth Circuit ruled that the district court had erred in awarding the insured's decontamination expenses.¹¹³

B. Contamination Coverage Under Debris-Removal Provisions

1. Debris-Removal Coverage

Another primary basis on which insureds may allege coverage for contamination losses is to claim a compensable expense for debris removal.¹¹⁴ Ordinarily, the cost of cleaning up debris produced by an insured peril is a legitimate item of loss that is covered under a property insurance policy.¹¹⁵ Under a typical debris-removal clause in a commercial property form, an insurer agrees to pay an insured's

¹¹⁰ *Id.* at 924. In explosion claims, courts usually have allowed the jury to weigh the evidence admitted and decide whether an explosion has occurred. Most courts have been reluctant to merely rely on the scientific opinions of physicists and engineers that an explosion, as scientists define the term, has taken place. Accordingly, in many instances insurers have been required to indemnify an insured for losses that were never intended to be covered under contracts insuring against explosion. THOMAS & REED, *supra* note 9, at 109.

¹¹¹ 248 F.2d at 923-24.

¹¹² *Id.* at 925; *see also* American Cas. Co. v. Myrick, 304 F.2d 179, 182-83 (5th Cir. 1962) (discussing the definitions of "explosion" adopted by various courts).

¹¹³ 248 F.2d at 931. Such costs were awarded by the Special Master under coverage for expenses necessarily incurred by the insured to reduce the business interruption losses. The Sixth Circuit Court of Appeals found, however, that no evidence established that the insured's expenditures for decontamination actually reduced business interruption losses. *Id.* at 930-31.

¹¹⁴ For reasons discussed below, the outlook for success in relying on this approach should vary depending on whether the debris-removal coverage is provided under a pre-1986 or a post-1986 standard policy form. *See infra* notes 156-89 and accompanying text.

¹¹⁵ 15 COUCH ON INSURANCE 2D § 54.184 (1983 & Supp. 1988). *See, e.g.*, Adams v. Northwest Farm Bureau Ins. Co., 40 Or. App. 159, 165, 594 P.2d 1256, 1258 (1979) (finding that the comprehensive fire policy unambiguously provided coverage for debris removal). Under the all risk Commercial Fire Policy Form CF 00 13 (Ed. 10 83) (Structure), debris removal is subject to the policy limit of coverage for property damage. Under the more recent commercial form designed to insure structures and personal property (CP 10 30 11 85), coverage is provided for debris removal as an additional coverage, with an exclusion of \$5,000 over the policy limit.

expenses incurred in removing debris of covered property arising from a covered loss.¹¹⁶ Therefore, in order to recover for debris removal, the insured should be required to establish that: (1) the substance to be removed is "debris"; (2) the "debris" is made up of "covered property"; and (3) a covered loss or insured peril caused damage requiring that the substance be removed.

The nationwide emphasis on cleaning up contaminants will undoubtedly increase claims under the debris-removal coverage for on-premises cleanup of pollutants.¹¹⁷ Insureds may argue that they are entitled to recover the expense of removing from the insured premises covered property that has become a contaminant. The term "debris" is usually not defined. An insured will employ the broadest possible definition consistent with common usage. The only express restriction under the clause is that coverage is usually limited to

¹¹⁶ Building and Personal Property Coverage Form CP 00 10 11 85. Such coverage is limited by other terms and conditions of the policy, including the dollar limit of property insurance provided. The Building and Personal Property Coverage Form states that expenses arising from the removal of debris of covered property will be paid when the debris is "caused by or resulting from a covered cause of loss." CP 00 10 11 85, section A.4a. Under the Limits of Insurance provision the same policy form states:

Payments under the following Additional Coverages will not increase the applicable Limit of Insurance:

1. Preservation of Property; or

2. Debris Removal; but if the sum of loss or damage and debris removal expense exceeds the Limit of Insurance, we will pay up to an additional \$5,000 for each location in any one occurrence under the Debris Removal Additional Coverage.

Id. Section C.2, Copyright, ISO, 1983. *See also* ISO forms HO-3 (Ed 4-84) and MP 0090 (Ed 07 77).

¹¹⁷ Fire Casualty and Surety Bulletin [hereinafter FC&S Bulletin], Nov. 1988, at EP-1 states: "Since the exception permitting coverage for 'sudden and accidental' pollution losses was removed from the commercial general liability forms . . . some insureds have been successful in finding coverage for on-premises cleanup of pollutants under the *debris removal clause* of their property policies." *Id.* (emphasis in original); *see, e.g.*, St. Paul Fire & Marine Ins. Co. v. Protection Mut. Ins. Co., 664 F. Supp. 323, 333 (N.D. Ill. 1987) (both insurers "assume[d]" that the cost of cleaning up PCB contamination at the insured's manufacturing plant was covered under the debris-removal clauses in their respective policies when PCBs were released due to a fire started by an electrical accident); Compass Ins. Co. v. Cravens, Dargin & Co., 748 P.2d 724 (Wyo. 1988) (property insurer was entitled to reimbursement from the insured's liability carrier for amounts paid to clean up oil that escaped from the insured's property onto adjacent property but was required to pay for removing the oil from the insured's own property under debris-removal coverage); *see also* Daniels, Wedged Enterprises v. Aetna Life & Cas. Co., No. IP 81-1413-C (S.D. Ind. June 29, 1983), *cited in* Glad & Barnes, *supra* note 1, at 9. Glad and Barnes report that "the court found coverage under a first-party [property] policy for PCB contamination cause[d] by a fire at the insured's premises. Since fire had lead [sic] to the release of the PCBs, removal of property contaminated with PCBs fell within the rubric of removing debris caused by the fire." *Id.*

debris made up of insured property that has been damaged by an insured peril.¹¹⁸

In the absence of an express policy definition, courts often will refer to dictionary definitions and will apply the term "debris" in a manner consistent with its regular usage.¹¹⁹ A common dictionary definition provides that debris is "the remains of something broken down or destroyed."¹²⁰ Using this approach, some courts have broadly interpreted the meaning of debris.¹²¹ Debris has been defined judicially as including the removal of "waste material resulting from the destruction of some article."¹²² Following a windstorm, trees and bushes not originally a part of the insured property have been treated as debris,¹²³ as have ruins from the fire-damaged portion of an inn.¹²⁴ These courts' expansive construction of the word "debris" does not bode well for a restrictive application of such coverage in claims for the cleanup of pollutants.

A case often relied upon by insureds to seek recovery for cleanup of contaminants under debris removal insurance is *Lexington Insurance Co. v. Ryder System, Inc.*¹²⁵ The all risk policy at issue covered all personal property owned, leased, or used by the insured.¹²⁶ A policy endorsement provided coverage for oil and pipelines. Fuel leaked from the underground storage tanks at the insured's place of business.¹²⁷ The insurer reimbursed the insured for the loss of oil. The insurer, however, refused the insured's claim to recover for the cost of removing from the ground the fuel that had escaped from the tanks.¹²⁸ The insured's claim for removal costs was submitted under the following provision: "*Debris Removal*. In the event of claim for physical loss or damage insured hereunder, this company shall also be liable for the cost of demolition and removal of debris formerly

¹¹⁸ See FC&S Bulletin, *supra* note 117, at Fire Dr-1. See § A.4.a of the Building and Personal Property Coverage Form CP 00 10 11 85.

¹¹⁹ See, e.g., *St. Paul Fire & Marine Ins. Co. v. Snitzer*, 183 Ga. App. 395, 396, 358 S.E.2d 925, 926 (1987); *Lexington Ins. Co. v. Ryder System Inc.*, 142 Ga. App. 36, 37, 234 S.E.2d 839, 839 (1977).

¹²⁰ WEBSTER'S NEW COLLEGIATE DICTIONARY 212 (1972); see also FC&S Bulletin, *supra* note 117, Fire & Marine, Debris Removal Coverage, Nov. 1986, at Fire Dr-3.

¹²¹ See, e.g., *Lexington*, 142 Ga. App. at 37, 234 S.E.2d at 839.

¹²² *Id.*

¹²³ *Snitzer*, 183 Ga. App. at 397, 358 S.E.2d at 926-27.

¹²⁴ See generally *Kossian v. American Nat'l Ins. Co.*, 254 Cal. App. 2d 647, 651, 62 Cal. Rptr. 225, 228 (1967).

¹²⁵ 142 Ga. App. 36, 234 S.E.2d 839 (1977).

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ *Id.*

an insured part of the property and no longer suitable for the purpose for which it was intended."¹²⁹

The trial court granted summary judgment in favor of the insured, and held the insurance company liable for the cost of removal.¹³⁰ On appeal, the insurance company argued that the oil did not constitute debris because it was not subject to demolition.¹³¹ The Georgia Court of Appeals rejected this reasoning.¹³² It concluded that "debris may mean merely waste material resulting from the destruction of some article."¹³³ Relying on a dictionary definition of "demolition," the court held that "escaped oil which has contaminated the surrounding earth is debris, and its removal is compensable because as oil in storage it was insured."¹³⁴ Although the insurance company argued that the debris-removal clause was inapplicable because there was no remaining property to demolish or tear down, the court construed the debris-removal provision in favor of the insured. In so doing, the court refused to define "demolish" narrowly to require proof by the insured that the remaining damaged portion of the insured structure had to be torn down in order to qualify for debris-removal coverage.¹³⁵

Based on *Lexington*, insureds may seek coverage for on-premises cleanup of pollutants under the debris-removal clause where the contaminant is residue of covered property.¹³⁶ Where such coverage is found, the insurer's liability under pre-1986 forms of debris-removal clauses can extend up to the limit of coverage for property damage.¹³⁷

Claims may also be asserted under debris-removal coverage for damage to uncontaminated covered property that is necessarily damaged in removing a contaminant from on-premises soil, water, per-

¹²⁹ *Id.*

¹³⁰ *Id.* at 37, 234 S.E.2d at 840.

¹³¹ *Id.*, 234 S.E.2d at 839.

¹³² *Id.*, 234 S.E.2d at 839-40.

¹³³ *Id.*, 234 S.E.2d at 839.

¹³⁴ *Id.*, 234 S.E.2d at 840.

¹³⁵ *Id.* The court declined to interpret the above clause as requiring the insured to establish "both a tearing down and a taking away" of covered property. *Id.*

¹³⁶ *Id.*

¹³⁷ FC&S Bulletin, *supra* note 117, Fire & Marine, at EP-1 (Pollution Changes). The editors of the FC&S Bulletin caution that under such an approach even a comparatively minor property loss can expose the entire property limit for debris removal. *Id.* The editors also warn that under the expansive interpretation that debris-removal coverage should automatically apply to all on-premises cleanup of pollutants, "even the fact that property policies specifically exclude land . . . [may not be] enough for coverage to be denied." *Id.*

sonal property, or buildings.¹³⁸ *Manduca Datsun v. Universal Underwriters Insurance Co.*¹³⁹ will be the likely basis for such claims. The policyholder in *Manduca Datsun* suffered substantial fire damage to an insured building where an automobile dealership formerly had been operated.¹⁴⁰ Under the general property coverage, the trial court denied recovery for asphalt damage expected to occur during the removal of debris because the asphalt was not damaged in the fire.¹⁴¹ The trial court also declined to allow recovery under the debris-removal coverage because damage to asphalt was not specifically included in the provision.¹⁴²

The Idaho Court of Appeals reversed and found coverage under a debris-removal clause providing, in relevant part:

DEBRIS REMOVAL—Coverage under this Coverage Part includes expense incurred in the removal of debris of property covered occasioned by LOSS insured against in this Coverage Part, but this Company shall not be liable . . . for more than the amount for which this Company would be liable, exclusive of debris removal expenses, if all the property covered at the LOCATION where the LOSS occurred were destroyed.¹⁴³

The record established that the most efficient way to remove the debris of the fire-damaged building was to use heavy equipment.¹⁴⁴ Evidence also showed the use of such equipment would necessarily produce asphalt damage.¹⁴⁵ The court held that any asphalt damage “actually and necessarily caused” by the debris-removal process fell within the insurance coverage for debris removal following a covered loss.¹⁴⁶

The court concluded that the economic purpose behind debris-removal coverage would be defeated if such coverage “did not provide payment for damage necessarily caused by the debris removal process itself.”¹⁴⁷ The appellate court remanded the case for a de-

¹³⁸ *Manduca Datsun v. Universal Underwriters Ins. Co.*, 106 Idaho 163, 168, 676 P.2d 1274, 1279 (1984).

¹³⁹ *Id.*

¹⁴⁰ *Id.* at 164–65, 676 P.2d at 1275–76.

¹⁴¹ *Id.* at 168, 676 P.2d at 1279.

¹⁴² *Id.*

¹⁴³ *Id.* at 168 n.3, 676 P.2d at 1279 n.3. The debris-removal clause that applied in *Manduca Datsun* was not a standard ISO debris-removal policy form. See MALLIN, *supra* note 4, at 104.

¹⁴⁴ *Manduca Datsun*, 106 Idaho at 168, 676 P.2d at 1279.

¹⁴⁵ *Id.*

¹⁴⁶ See *id.*

¹⁴⁷ *Id.*

termination of the amount of asphalt damage actually and necessarily incurred by debris removal.¹⁴⁸

2. Possible Expanded Applications of Debris-Removal Insurance

As one commentator has concluded, the rationale for coverage expressed in *Manduca Datsun* may provide a basis for a significant expansion of debris-removal coverage under pre-1986 policies as interpreted by some courts at the urging of insureds.¹⁴⁹ An insured may contend that debris-removal coverage must apply to damage to *any* property, not just insured property, necessarily resulting from the process of removing covered property turned into contaminant.¹⁵⁰ Relying on *Lexington*, insureds may also seek coverage for cleaning up pollution from adjacent noncovered land and water caused by a leak of insured property turned contaminant.¹⁵¹ Such claim scenarios are plausible under the standard debris-removal coverage offered before 1986 because insurers usually have paid the cost of removing from off-premises locations the debris of covered property.¹⁵²

Expenses associated with cleaning up radioactive, toxic, or otherwise hazardous debris can be staggering.¹⁵³ Special procedures for cleaning up, handling, and disposing of the hazardous debris may be required.¹⁵⁴ Extra transportation costs likely will be incurred to remove and transport the material to specially designated dump sites according to hazardous waste statutes and regulations.

The devastating potential of a dramatic rise in debris removal claims for cleaning up environmental pollution did not go unheeded by the insurance industry. The prospect of a significant jump upward

¹⁴⁸ *Id.*

¹⁴⁹ See MALLIN, *supra* note 4, at 24. Mallin has articulated a six-point "laundry list" of potential ambiguities in the standard ISO debris-removal policy form that was regularly issued by insurers prior to 1986. *Id.* at 25. He posits that such lack of clarity in drafting may provide a basis for insureds to urge an expansion of debris-removal coverage beyond that recognized in *Manduca Datsun* and *Lexington*, in the context of cleaning up pollution. *Id.* at 24-26.

¹⁵⁰ *Id.* at 24.

¹⁵¹ *Id.* at 22-23.

¹⁵² *Id.* at 20-21.

¹⁵³ See FC&S Bulletin, *supra* note 117, Fire & Marine, Debris Removal Coverage, Nov. 1986, at Fire Dr-6. The editors caution that, when purchasing debris-removal coverage, an insured must take into account potential contamination of otherwise undamaged property by smoke or water that has absorbed radioactive or toxic material as a result of a fire or other accident. *Id.*

¹⁵⁴ *Id.*

in such claims was a major factor in the 1986 promulgation of a revised standard policy form for debris-removal coverage.¹⁵⁵

3. Revisions to Debris-Removal Coverage Forms and Additional Coverage for Cleanup and Removal of Pollutants

Two new pollution endorsements¹⁵⁶ for commercial policies have been adopted to clarify the intent behind coverage for debris removal.¹⁵⁷ These endorsements limit the scope of potential coverage for contamination claims in terms of time, location, and extent of liability. In 1986, the Insurance Services Office Commercial Property Committee (ISO Committee) promulgated these new endorsements for commercial policy lines titled "Changes—Pollutants" (basic endorsement)¹⁵⁸ and "Pollutant Clean Up and Removal—Additional Aggregate Limit of Insurance" (extra endorsement).¹⁵⁹

¹⁵⁵ Ozog & Ponzi, *Pollution Coverage—New ISO Forms and Insured Events*, reprinted in *Environmental Claims*, *supra* note 4. Ozog and Ponzi note that ISO proposed new policy form endorsements for debris-removal coverage in response to the expansion of such insurance to cover the cleanup of on-premises pollution by certain courts. *Id.* at 178; *see also* FC&S Bulletin, *supra* note 117, at EP-1 (Pollution Changes) ("[The] Insurance Services Office filed an interim endorsement, *changes-pollutants CP 01 86* to clarify that the debris-removal clause did not extend to cover the clean up of sudden and accidental pollution losses and to introduce limited coverage to apply to these clean up costs.").

¹⁵⁶ The term "endorsement" refers to special provisions added to the standard policy form in order to complete the insurance contract. Endorsements supercede the terms and conditions stated in the standard policy form and may be altered by later endorsements. Standard policy forms sometimes do not suit a particular need of the insurer or the insured pertaining to the risks that are to be covered. In such circumstances, endorsements are often used to modify the standard coverage and satisfy the unique requirements of the contracting parties. At the time coverage is applied for, endorsements may be used to alter the main policy to add coverage for additional perils, property, losses, insured locations, hazards, and insured persons. Conversely, endorsements may be used to eliminate specific coverages otherwise provided in the standard form. Further, after the policy of insurance is issued, endorsements may be added to revise the amount of insurance, correct errors in the contract, adjust a premium rate, or include coverage of newly acquired property. MEHR & CAMMACK, *supra* note 8, at 141.

¹⁵⁷ The insurance industry's ultimate objective is to incorporate the changes in the basic endorsement, not only into the Commercial Property (CP) forms, but also into the Commercial Fire (CF) forms, the Special Multi-Peril (MP) forms, and the Business Owners (BO) forms. MALLIN, *supra* note 4, at 95. There are no plans to offer the excess coverage for removal of pollutants provided by the extra endorsement under any form other than the Commercial Property (CP) forms. *Id.* The issues addressed in these two new endorsements were also referred for consideration to an Ad Hoc Form Committee of the ISO to develop parallel changes for the farm coverage forms. Presently, there is no intention to incorporate similar changes in Personal Lines coverage, *i.e.*, Homeowners Policy forms. *Id.*

¹⁵⁸ CP 01 86 04 86 (1986). This is a mandatory endorsement affecting the debris-removal coverage contained in virtually all commercial policies. Ozog & Ponzi, *supra* note 155, at 178; *see also* FC&S Bulletin, *supra* note 117, at EP-1.

¹⁵⁹ CP 04 07 04 86 (1986). Since its introduction, the extra endorsement has been revised to

a. Reporting Restrictions

Under the basic endorsement, coverage for debris removal is limited to expenses reported to the insurance company within 180 days of whichever is earlier: (1) the date of the direct physical loss or damage, or (2) the end of the policy term.¹⁶⁰ The date triggering subsection (1) is apparently intended to be the date on which the covered property became debris.¹⁶¹ The provision reflects an effort to eliminate excessively tardy reporting of debris-removal claims. This should preclude the receipt of stale claims for debris removal. The endorsement also circumvents the need for insurers to maintain extensive claim records for "late manifestations."¹⁶²

The basic endorsement contains no reference to the date debris-removal expenses are actually incurred, but focuses on the date the loss is reported to the insurer.¹⁶³ Oral notification of the claim will apparently suffice, as no requirement of written notice is stated.¹⁶⁴ There is no requirement that the debris-removal expenses must have been incurred by the insured at the time they are reported to the insurer.¹⁶⁵ The basic endorsement does not expressly restrict the coverage for removal of debris to designated premises and does not define "debris."¹⁶⁶

b. Dollar Limit of Liability

To avoid triggering the policy limits for debris removal where a property loss is minor, a new dollar limitation has been added.¹⁶⁷ The ISO Committee determined that open-ended debris-removal coverage was not intended to be in effect for cleaning up covered property turned contaminant.¹⁶⁸ A limitation of coverage for debris removal of up to twenty-five percent of the amount of the insured loss, or loss payment plus deductible, is contained in the basic en-

add the Standard Property Policy (CP 00 99 07 88) to the list of coverage forms it modifies. The extra endorsement has not been substantively revised, but is now denominated as CP 04 07 07 88. Ozog & Ponzi, *supra* note 155, at 187.

¹⁶⁰ Section A.2.a(1)(2). See FC&S Bulletin, *supra* note 117, at EP-2 (Pollution Changes).

¹⁶¹ MALLIN, *supra* note 4, at 97.

¹⁶² *Id.*; see also Ozog & Ponzi, *supra* note 155, at 183.

¹⁶³ MALLIN, *supra* note 4, at 98.

¹⁶⁴ *Id.*

¹⁶⁵ *Id.* at 122.

¹⁶⁶ *Id.* at 123.

¹⁶⁷ *Id.* at 100.

¹⁶⁸ *Id.* at 101.

dorsement.¹⁶⁹ An extra debris-removal limit of up to \$5,000 applies over and above the percentage limit, and constitutes additional debris-removal coverage beyond the Limits of Insurance stated in the policy declarations.¹⁷⁰

c. Exclusion for Pollutant Removal

The cost of extracting pollutants from land or water is not covered as debris-removal Additional Coverage, and neither is the cost of restoring or replacing polluted land or water, either on or off the insured premises.¹⁷¹ There is also no coverage for the expense of cleaning up contaminated soil.¹⁷² Debris-removal Additional Coverage may apply, however, to the cost of removing pollutants from buildings and personal property, on or off the insured premises, for which there is no express exclusion.¹⁷³ The term "pollutants" here is expressly defined.¹⁷⁴

¹⁶⁹ Section A.2.b(1)(2). Ozog & Ponzi, *supra* note 155, at 181. Ozog and Ponzi illustrate the operation of this clause with the following example: "A \$5,000 property damage loss with a \$500 deductible would afford \$1,375 (25% of \$5,000 plus \$500 [deductible]) of debris-removal coverage." *Id.*; see also FC&S Bulletin, *supra* note 117, Fire & Marine, at EP-1.

¹⁷⁰ Section A.4. See FC&S Bulletin, *supra* note 117, Fire & Marine, at EP-1 (explaining that, if the coverage under the basic endorsement for debris-removal expense is insufficient, up to \$5,000 of additional coverage is available on a "per occurrence" basis); MALLIN, *supra* note 4, at 101-02. By purchasing the coverage provided under ISO endorsement CP 04 15, the insured can increase the amount of additional debris-removal coverage beyond the \$5,000 limit stated in the basic endorsement. FC&S Bulletin, *supra* note 117, Fire & Marine, at EP-1, E-4 (Commercial Property).

¹⁷¹ See Section A.2.c(1)(2). (Commercial Property). The editors of the FC&S Bulletin conclude that section A.2.c(1)(2) of the basic endorsement should preclude coverage for expenses incurred for the extraction of "pollutants" from the described premises or for the removal, restoration, or replacement of environmentally impaired portions of the described premises. FC&S Bulletin, *supra* note 117, at EP-2. Ozog and Ponzi note that "the [basic] endorsement distinguishes between 'debris removal' and 'pollution clean-up and removal' from land or water at the described premises" and state, therefore, that the revised ISO form "eliminat[es] the basis for the argument previously propounded by insureds that pollution clean-up expenses are covered under the debris-removal clause." Ozog & Ponzi, *supra* note 155, at 182.

¹⁷² CP 00 10 11 85. In addition to the clarification in Section A.4 of the basic endorsement, the Building and Personal Property Coverage Form CP 00 10 11 85 expressly provides: "Covered Property does not include . . . land (including land on which the property is located) . . . [That] coverage should not apply to the clean-up of polluted land on the insured premises is strengthened by the inclusion of land as property not covered in the primary policy form. See also MALLIN, *supra* note 4, at 118-19.

¹⁷³ See MALLIN, *supra* note 4, at 103-04 (by negative implication, the above section "does apply to the cost of removing 'pollutants' from buildings and personal property [on or off the described premises]") (emphasis in original).

¹⁷⁴ Section A.5. provides: "Pollutants means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalies, chemicals and waste." The definition of "pollutants" contained in the basic endorsement is identical to that set forth in CGL policy forms. See MALLIN, *supra* note 4, at 110.

d. Additional Coverage for Pollutant Cleanup and Removal

Claims for the expense of extracting pollutants from land and water on insured premises have been provided for by additional coverage with a comparatively low aggregate liability limit, stated separately from the debris-removal coverage in the basic endorsement.¹⁷⁵ The newly created pollutant clean-up and removal coverage provides up to \$10,000 of additional coverage for the cost of extracting pollutants from water or land on the designated premises.¹⁷⁶ There is no coverage for neutralizing the toxic effects of pollutants, only their removal or extraction is covered.¹⁷⁷ The basic endorsement provides no coverage to defray the cost of removing or extracting pollutants from land or water on premises away from the described premises.¹⁷⁸

Coverage is limited to pollutant clean-up and removal expenses arising out of "Covered Causes of Loss."¹⁷⁹ The \$10,000 limitation of additional coverage is calculated on losses "occurring during each separate 12-month period of this policy."¹⁸⁰ The ISO Committee reportedly intended the latter phrase to mean an annual aggregate and to comprise the time interval between anniversary dates of the policy, assuming an annual renewal term.¹⁸¹ The aggregate limit is intended to unambiguously limit the insurer's exposure to no more than \$10,000 during any one policy year, even when multiple occurrence claims are presented.¹⁸² There is a 180-day reporting requirement under this Additional Coverage, similar to that set forth in the basic endorsement.¹⁸³

¹⁷⁵ Section A.3. See also Ozog & Ponzi, *supra* note 155, at 5; FC&S Bulletin, *supra* note 117, at EP-2 (Commercial Property) (coverage for pollutant cleanup and removal characterized as "a new additional coverage" introduced in conjunction with the revised ISO debris-removal form).

¹⁷⁶ FC&S Bulletin, *supra* note 117, at EP-2 (Commercial Property). The \$10,000 annual aggregate limit of coverage applies at any described premises if the pollution damage is caused by a covered cause of loss during the policy period. *Id.*; see also Ozog & Ponzi, *supra* note 155, at 182-83.

¹⁷⁷ MALLIN, *supra* note 4, at 119-20.

¹⁷⁸ See *id.* at 119.

¹⁷⁹ CP 10 20 11 85, Section A.3.

¹⁸⁰ *Id.*, Section A.3.b.

¹⁸¹ MALLIN, *supra* note 4, at 107.

¹⁸² *Id.* at 108. Because of the relatively low amount of coverage involved, the ISO Committee sought to simplify potential coverage disputes by setting a \$10,000 aggregate limit and permitting coverage for unlimited occurrences under the basic endorsement. *Id.*; see also FC&S Bulletin, *supra* note 117, Fire & Marine, at EP-2; Ozog & Ponzi, *supra* note 155, at 5-6.

¹⁸³ Section A.3. This section provides that such expenses will be paid only if they are

e. Increased Aggregate Limit of Coverage for Pollutant Cleanup and Removal

An insured can purchase an additional aggregate limit of insurance to cover the cleanup and removal of pollutants from land and water at specified locations.¹⁸⁴ Such coverage is available under the extra endorsement¹⁸⁵ for an additional premium.¹⁸⁶ The extra endorsement does not modify the basic endorsement,¹⁸⁷ but it provides an additional annual aggregate limit as excess insurance.¹⁸⁸ No coverage is intended or expressed under the extra endorsement for removal or extraction of pollutants from off-premises land or water.¹⁸⁹

We have examined potential bases contained within property insurance policies on which an insured may rely to urge that there is coverage for a pollution-related claim. Whether the basis of the claim for coverage is an allegation that pollution comprises an insured peril or that the contamination loss should be covered as debris removal, however, there usually should be valid defenses to the claim based on the express language of the policy. An insured's claim may fail to satisfy some essential prerequisite for coverage or the claim may be expressly excluded by a provision barring coverage for certain risks.

reported to the insurer within 180 days of the earlier of the date of direct physical loss or damage or the end of the policy period. See FC&S Bulletin, Fire & Marine, *supra* note 117, at EP-2 (Commercial Property); Ozog & Ponzi, *supra* note 155, at 182-83.

¹⁸⁴ FC&S Bulletin, *supra* note 117, at EP-2, E-3 (Commercial Property). The editors explain that under the additional endorsement, the insured can schedule an additional annual aggregate amount for the cleanup and removal of pollutants from land or water on the insured's premises. *Id.*

¹⁸⁵ CP 04 07 04 86. That form was recently revised to add the Standard Property Policy form CP 00 99 07 88 to the list of forms it modifies. Ozog & Ponzi, *supra* note 155, at 187.

¹⁸⁶ MALLIN, *supra* note 4, at 111-12.

¹⁸⁷ See Ozog & Ponzi, *supra* note 155, at 187.

¹⁸⁸ The extra endorsement of CP 04 07 04 86 provides:

B. We will not pay under this endorsement for pollutants cleanup or removal costs in any occurrence until the total of all such costs exceeds the sum of:

1. The \$10,000 aggregate limit from the basic Pollutant Clean Up and Removal Additional Coverage, less any prior payments for the same policy year; plus
2. The deductible shown in the Schedule.

We will then pay the costs in excess of that sum, until the Additional Aggregate Limit of Insurance shown in the Schedule is used up during the applicable 12-month period.

MALLIN, *supra* note 4, at 111-12. See FC&S Bulletin, *supra* note 117, at E-3 (Commercial Property). The editors note that the additional aggregate amount for pollutant cleanup is excess insurance over the \$10,000 limit on the ISO coverage form to which the endorsement is attached. They point out that a deductible is scheduled on the endorsement to match the largest property damage deductible appearing in the policy (within a minimum of \$1,000). *Id.* The editors also provide a helpful illustration of the application of the additional coverage under the extra endorsement for the removal of pollutants from an insured's premises. *Id.*

¹⁸⁹ MALLIN, *supra* note 4, at 111.

III. POTENTIAL DEFENSES BASED ON THE RESTRICTED SCOPE OF PROPERTY POLICY COVERAGE

Not all property damage losses are insurable.¹⁹⁰ Even under standard all risk policy forms, not every risk is covered.¹⁹¹ Restrictions on the scope of coverage under property insurance policies are properly taken into account by insurers in evaluating whether coverage exists for contamination-related claims. An insured bears the burden of proving its loss falls within the scope of coverage provided under the insuring agreement.¹⁹² To meet this burden, an insured must establish a direct physical loss to covered property proximately caused by a peril insured against during the policy term.¹⁹³ In addition, standard commercial and homeowners property forms provide a number of limitations and exceptions that should negate coverage for contamination losses.¹⁹⁴ In evaluating whether coverage exists, an insurer should consider the following elements that an insured is required to prove by a preponderance of the evidence.

A. *Direct Loss*

Under certain circumstances, when the policy so requires,¹⁹⁵ an insurer may defend by contending that a loss does not comprise a *direct* loss. This defense may be considered under circumstances when factors of time, distance, or excluded perils render the actual cause of the claimed loss too remote.¹⁹⁶ The requirement of direct

¹⁹⁰ See J. MAGEE & O. SERBEIN, *PROPERTY AND LIABILITY INSURANCE* (4th ed. 1967). Magee and Serbein make a distinction between insurance claims and insured losses. They point out that there is not automatically coverage under an insurance contract simply because the insured has suffered a loss. For an insurance claim to constitute loss, the loss must fall within the coverage provided under the terms and conditions of the applicable policy. *Id.* at 830.

¹⁹¹ THOMAS & REED, *supra* note 9, at 123-24.

¹⁹² See, e.g., *Grzadzielewski v. Walsh County Mut. Ins. Co.*, 297 N.W.2d 780, 784 (N.D. 1980) (no coverage because the evidence presented did not establish facts showing that the loss was a direct loss due to wind); *Paris*, *supra* note 4, at M-4.

¹⁹³ Hook, *supra* note 4, at 1.

¹⁹⁴ MEHR & CAMMACK, *supra* note 8, at 139. The authors remark that an insurance contract is one of the few important contracts people regularly enter into obligations under without reading its contents. Mehr and Cammack contend that: "Many insurance buyers seemingly believe that the exclusions and conditions included in modern contracts of insurance are so negligible and unimportant that they are not worth reading." *Id.*

¹⁹⁵ See *Marshall Produce Co. v. St. Paul Fire & Marine Ins. Co.*, 256 Minn. 404, 418, 98 N.W.2d 280, 290-91 (1959) (court found that, unlike the "New York form," the Minnesota form of standard policy did not require that a fire be a "direct" cause of the loss for coverage).

¹⁹⁶ See, e.g., *Brothers, Inc. v. Liberty Mut. Fire Ins. Co.*, 268 A.2d 611 (D.C. 1970) (no coverage under the insured's business interruption policy for losses due to a precipitous decline in customers at the insured's restaurant).

loss may exclude losses that flow from, but do not comprise, physical loss to property.¹⁹⁷

In *Blaine Richards & Co. v. Marine Indemnity Insurance Co. of America*,¹⁹⁸ the Second Circuit Court of Appeals required the insured to prove that its losses were directly caused by physical damage to imported beans by the fumigant Phostoxin,¹⁹⁹ a covered peril, rather than by the governmental detention of undamaged beans only suspected of being contaminated, an excluded peril.²⁰⁰ In the latter event, the insured's losses would be due only remotely to the exposure of the beans to Phostoxin and there would be no coverage.²⁰¹ The insured, a shipper of goods, sued to recover on two marine insurance policies for losses sustained when a shipment of beans from Europe was temporarily detained, by order of the Food and Drug Administration, upon arrival in the United States. During the

¹⁹⁷ In *North River Insurance Co. v. Clark*, 80 F.2d 202, 203 (9th Cir. 1935), there was no coverage under a fire policy for the loss of use of a locomotive that was untouched by a forest fire, but was not accessible for use. The receiver in bankruptcy of the insured sought to recover on a fire policy due to the collapse of railroad bridges during a forest fire. The stipulated facts before the court were that the fire left the locomotive untouched and undamaged. Nevertheless, the locomotive was so isolated as a result of the forest fire that it would cost all the locomotive was worth to render it accessible for use. In denying coverage, the court noted the alleged loss actually resulted from the insured's unwillingness or inability to rebuild the bridges and was not caused by the fire. *Id.* at 203. *But see* *Marshall Produce Co. v. St. Paul Fire & Marine Ins. Co.*, 256 Minn. 404, 435, 98 N.W.2d 280, 301 (1959). In a result-oriented decision, the Minnesota Supreme Court distinguished and declined to apply *North River*. The court found coverage for the loss in value of the insureds' egg powder due to smoke exposure because, unlike the locomotive in *North River*, there was no possible way the insureds could recover the value of the egg powder.

¹⁹⁸ 635 F.2d 1051 (2d Cir. 1980); *see also* *Bender Shipbldg. & Repair Co. v. Brasileiro*, 874 F.2d 1551, 1560, 1561 & n.10 (11th Cir. 1989) (collision liability clause of a builder's risk marine policy did not cover the shipbuilder's liability for liquidated damages for delay in the delivery of a floating drydock). In *Bender*, the court observed that "marine insurance interpretation strictly applies the doctrine of *causa proxima non remota spectatur* ('the immediate not the remote cause is considered') and a court should not attempt to trace the origin of losses back to remote causes." 874 F.2d at 1559 (citing *Blaine Richards*).

¹⁹⁹ Phostoxin was a pesticide widely used in Europe, which had not been approved by the FDA. *Bender*, 874 F.2d at 1052.

²⁰⁰ *Id.* at 1055-56.

²⁰¹ *Id.* The district court ruled that there would be no coverage for losses arising from "temporary physical loss of the beans" due to detention by the FDA. The court of appeals concluded that the insured's pleadings were imprecise in stating the exact source of loss or damage on which it relied in seeking insurance proceeds. It remanded the case, instructing the district court to determine whether any of the beans were so damaged by contamination with Phostoxin that contracts were cancelled due to the contamination, or whether cancellation of contracts was due only to the delay caused by temporary detention. There were apparently no exclusions in the policies for losses due to contamination. Losses sustained in reconditioning the beans or losses due to rejection of reconditioned beans by purchasers because of the physical condition of the beans would not be excluded. *Id.*

period of detention, which lasted more than six weeks, the insured applied for permission to segregate, clean, and rebag the beans that were found to contain residue of the pesticide.²⁰² The FDA approved the insured's proposal and immediately released the "clean bags" of beans that were unaffected by Phostoxin, and agreed to the reconditioning and release of the bags of beans containing Phostoxin residue.²⁰³

The beans ultimately had to be resold at a loss when the original sales contracts, both for the undamaged beans and for beans that were contaminated with Phostoxin residue, were cancelled.²⁰⁴ The applicable policies provided no coverage for financial losses caused solely by governmental seizure and detention of the beans.²⁰⁵ The court of appeals therefore ruled that, in order for the insured to recover under the policies, it had to prove that the original purchasers rejected the beans because of their physical condition, rather than because of the delay caused by governmental detention.²⁰⁶

The insured argued that, even if a detention of the beans fell within the policy exclusions, the *proximate cause* of the financial losses was the improper fumigation of some of the beans with Phostoxin.²⁰⁷ The insured asserted that coverage should exist for losses on both the "clean" and "dirty" bags of beans. That should be the result, the insured contended, because "but for" the improper fumigation the detention by the FDA would not have occurred.²⁰⁸

The Second Circuit Court of Appeals rejected the insured's contention that all of its losses were covered as being proximately caused by improper fumigation.²⁰⁹ In discounting the insured's position, the court sought to determine the immediate cause of the losses and declined to trace the losses back to their remote causes.²¹⁰ The court concluded that fumigation with Phostoxin was a remote

²⁰² *Id.* at 1052.

²⁰³ *Id.*

²⁰⁴ *Id.*

²⁰⁵ *Id.* at 1053-54, 1056. One of the marine policies was an all risk policy, which excluded coverage for losses due to "detainment, confiscation . . . and the consequences thereof" [the standard "Free from Capture and Seizure Clause"] and for "loss, damage or deterioration arising from delay." A second marine policy insured against risks otherwise excluded under the standard Free from Capture and Seizure Clause in the all risk policy, but excluded coverage for losses caused by "[s]eizure or destruction under quarantine or customs regulations" or "[d]elay, deterioration and/or loss of market." *Id.* at 1052-53.

²⁰⁶ *Id.* at 1055-56.

²⁰⁷ *Id.* at 1054-55 & n.2.

²⁰⁸ *Id.* at 1054.

²⁰⁹ *Id.* at 1055.

²¹⁰ *Id.* at 1054-55.

cause of the losses arising from resale of the undamaged beans, which directly resulted from the detention.²¹¹ The predominant and determining, also known as the "real efficient," cause of such loss was the detention, coverage for which was barred by both policies. The insured could only recover upon proof that direct physical loss or damage had occurred to the beans and resulted in the losses.²¹²

The defense that direct loss refers *only* to a loss resulting from the force of the designated peril on the insured property, however, probably will not be dispositive.²¹³ Many courts have equated direct loss with proximate cause,²¹⁴ and have applied it to first-party claims in a fashion similar to its meaning in negligence cases.²¹⁵ The mere presence of intervening time or distance between the happening of the event and resulting loss by contamination does not mean the peril was a remote cause of the loss.²¹⁶ Rather, the court will seek

²¹¹ *Id.*; see also *Grzadzielewski v. Walsh County Mut. Ins. Co.*, 297 N.W.2d 780, 784 (N.D. 1980). The court affirmed a jury verdict and found that the insured had failed to prove a direct loss by a covered peril. The applicable policy insured against "direct loss by windstorm." *Grzadzielewski*, 297 N.W.2d at 785 n.2. The insured sued to recover under the policy, contending that wind had blown open a gate to a cattle pasture permitting his cattle to reach a feeder and consume an amount of food that proved to be fatal. The North Dakota Supreme Court found that the evidence presented at trial failed to establish that the death of insured cattle constituted a direct loss due to wind. *Id.* at 785.

²¹² *Blaine Richards*, 635 F.2d at 1055-56.

²¹³ See, e.g., *Louisville and Jefferson County Metro. Sewer Dist. v. Travelers Ins. Co.*, 753 F.2d 533, 537 (6th Cir. 1985). The insurer denied coverage under a policy insuring against direct loss by willful and malicious damage for damage to a sewage treatment plant caused by illegal dumping of toxic waste. The insurer defended, in part, by alleging that the policy did not afford coverage because the damage to the treatment plant was not immediate or expected. The insurer argued that the damage was too remote in time and place to be the result of vandalism or malicious mischief. It pointed out that the damage to the treatment area occurred several days after the dumping, that it took time for the toxic waste to move the three miles through the sewer system to the plant, and that it took additional time for the toxic waste to build up to damaging levels there. *Id.* at 536. The court rejected these arguments and held that the "loss was direct because there was no intervening act or agency; the toxic waste moved in the normal operation of the sewer system from the manhole to the treatment plant." *Id.* at 537; see also *Gibson v. Secretary of United States Dep't of Hous. & Urban Dev.*, 479 F. Supp. 3, 4-6 (M.D. Pa. 1978) (court agreed with the insured's contention that a policy insuring their dwelling against direct loss by flood did not require physical damage to the premises caused by actual touching of flood waters, but that any loss proximately resulting from a flood was covered).

²¹⁴ 18 COUCH ON INSURANCE 2D § 74.712 (1983 and Supp. 1988). "The words 'direct cause' are synonymous in legal intent with proximate cause." *Id.* See, e.g., *Marshall Produce Co. v. St. Paul Fire & Marine Ins. Co.*, 256 Minn. 404, 415, 98 N.W.2d 280, 289 (1959) (discussing that the word "direct" within a fire policy has been held to mean "immediate" or "proximate," as distinguished from "remote").

²¹⁵ See, e.g., *Grzadzielewski v. Walsh County Mut. Ins. Co.*, 297 N.W.2d 780, 783 (N.D. 1980).

²¹⁶ In determining whether a direct loss has occurred, many courts apply a definition meaning "that cause which in a natural and continuous sequence unbroken by any new and intervening cause produces a loss, and without which the loss would not have occurred." Federal Ins. Co.

to determine the predominant and determining, or the real efficient, cause of the loss.²¹⁷ For example, in *Henri's Food Products Co. v. Home Insurance Co.*,²¹⁸ the policy insured the product against direct loss caused by smoke. The court found coverage even though only the packaging of the insureds' product contained residue of the toxic chemical vapor.²¹⁹

The use of the word "direct" to modify the word "loss" generally has not been interpreted as altering the application of the usual principles of proximate causation by the courts that have considered the issue.²²⁰ Nevertheless, when policy language and circumstances of a claim support such a defense, an insurer correctly may evaluate whether the loss at issue satisfies the requirement of a "direct loss" for coverage.

B. Physical Loss

Standard all risk homeowners and commercial property policies limit recovery to physical damage.²²¹ Some courts have shown a

v. Bock, 382 S.W.2d 305, 307 (Tex. Civ. App. 1964) (insured suffered a direct loss by windstorm and hurricane when his meat in cold storage vaults spoiled due to a rise in temperature proximately caused by hurricane damage to transmission lines that halted electricity); see also *Fred Meyer, Inc. v. Central Mut. Ins. Co.*, 235 F. Supp. 540, 542-44 (D. Or. 1964).

²¹⁷ See, e.g., *Blaine Richards & Co. v. Marine Indem. Ins. Co.*, 635 F.2d 1051, 1054 (2d Cir. 1980) (citing *Standard Oil Co. v. United States*, 340 U.S. 54, 58 (1950)).

²¹⁸ 474 F. Supp. 889 (E.D. Wis. 1979).

²¹⁹ *Id.* at 890-91. A private testing concern determined that the insured's pourable salad dressing, which was bottled and sealed in cartons, was not affected. Only the packaging was permeated with the chemical. Nevertheless, the insured "determined that the product should be destroyed for the good of the company's reputation of high-quality products." *Id.* at 891. In ruling on the insured's motion for summary judgment on the issue of coverage under the policy, the court noted that the insurance company "offered no contrary evidence as to the fact that the [chemical vapor] residue contacted [the insured's] products in the warehouse." *Id.* Citing to the requirement of Federal Rule of Civil Procedure 56(e) that a party opposing summary judgment cannot rely solely on its pleadings and must demonstrate a genuine issue of fact, the court found that the insured had "produced unrefuted facts showing that [it had] suffered a peril that caused an injury." *Id.* at 891; see also *Marshall Produce Co. v. St. Paul Fire & Marine Ins. Co.*, 256 Minn. 404, 429, 98 N.W.2d 280, 297 (1959) (interpreting policies insuring poultry, eggs, and milk powder that included "filled containers," the court concluded that "the cans, labels, and cases are as much a part of the products as the contents . . . [and] the entire unit is the property which is insured").

²²⁰ See *supra* note 211. At least one commentator from an insurance defense perspective has cautioned that too much emphasis has been placed on the requirement of a direct loss for a finding of coverage. See Miller, *Property Insurance for Environmental Claims—Physical Loss and Damage to Insured Property*, reprinted in *Environmental Claims*, *supra* note 4, at 29. Miller has concluded that the word "direct" as a modifier for coverages is superfluous because it simply restates a requirement of proximate causation between the insured peril and damage or loss that is already imposed as a matter of law. *Id.* at 32.

²²¹ See Miller, *What Constitutes Property Damage Under an All-Risk Insurance Policy*, in *THE ALL RISK POLICY: ITS PROBLEMS, PERILS AND PRACTICAL APPLICATION*, 1986 ABA

reluctance to extend coverage under policies requiring physical loss if an insured has failed to prove a loss resulting from physical damage to covered property.²²²

Court definitions of the term "property damage" in standard Comprehensive General Liability (CGL) policies illustrate the impact of the physical damage requirement on coverage analysis.²²³ Many courts have given a broad interpretation to the phrase "property damage" in liability policies where the phrase was not limited to mean physical injury.²²⁴ Without the requirement of physical injury,

SEC. TORT AND INS. PRACTICE 11. In arguing that proof of a "physical loss" should be a prerequisite to a finding of coverage under even an all risk policy, Miller states: "Physical damage is an element of liability frequently overlooked in view of the expansion of insured perils to all risks. Nonetheless, there still must be physical loss or damage [for coverage]." *Id.* at 12.

²²² See, e.g., *Blaine Richards & Co. v. Marine Indem. Ins. Co.*, 635 F.2d 1051, 1056 (2d Cir. 1980) (holding that no coverage existed for losses to imported beans caused by delay due to detention by the FDA, but that coverage would exist upon a finding on remand that other losses arose from damage to the physical condition of the beans); *Glens Falls Ins. Co. v. Covert*, 526 S.W.2d 222, 223 (Tex. Civ. App. 1975) (insured failed to prove that he suffered physical loss or damage when his products, which were sealed in a manner preventing inspection for damage, fell to the floor while in storage, and he decided not to sell the units when the manufacturer withdrew its warranty that the products were free of defects); *Fruehauf Corp. v. Royal Exch. Assur. of Am.*, 704 F.2d 1168, 1172 (9th Cir. 1983) (no coverage for the alleged conversion of tractors by a third party, who refused to deliver the tractors, because the refusal to deliver did not constitute "physical loss or damage" and there was no evidence that any of the tractors were damaged or destroyed); *HRG Dev. Corp. v. Graphic Arts Mut. Ins. Co.*, 26 Mass. App. Ct. 374, 376-78, 527 N.E.2d 1179, 1180-81 (1988) (insured's all risk policy applied only to physical losses and there was no coverage for losses due to a defect in the title of equipment acquired by the insured); *State v. Glens Falls Ins. Co.*, 132 Vt. 97, 100, 315 A.2d 257, 259 (1974) (under a policy insuring the liability of the insured for physical injury to, or destruction of, tangible property, insurer was not obligated to defend suit against insured where color slides, for possible use in a magazine article, disappeared without any evidence of actual destruction).

²²³ In deciding liability coverage disputes governed by CGL standard policy forms, the courts have carefully examined the policy language itself in determining whether a given incident constituted property damage. Prior to 1966, "property damage" was defined in CGL policies as "injury to or destruction of property, including loss of use thereof." The 1966 revised version of the CGL standard policy form defined "property damage" as "injury to or destruction of tangible property." *Tinker, Comprehensive General Liability Insurance—Perspective and Overview*, 25 FED'N INS. COUNS. Q. 217, 232 (1975). Following the 1973 revisions, the standard CGL form defined "property damage" as constituting:

- (1) physical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom, or
- (2) loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an *occurrence* during the policy period.

Id. at 239 (emphasis in original). The 1985 CGL revision retains a definition of "property damage" that is substantially identical to that in the 1973 CGL form, with only a non-substantive editorial change.

²²⁴ See, e.g., *United States Fidelity & Guar. Co. v. Mayor's Jewelers*, 384 So. 2d 256, 258 (Fla. Dist. Ct. App. 1980) ("If [under the 1966 CGL form] . . . property is damaged only when

these courts have interpreted property damage to be comprised of consequential or intangible property losses, in addition to direct physical damage.²²⁵ Absent the criterion of physical injury, the incorporation of a defective component into tangible property has been found to constitute property damage, if it resulted in a decrease in market value of the property.²²⁶ In *Hauenstein v. St. Paul-Mercury Indemnity Co.*,²²⁷ defective plaster that shrank and cracked forced the contractor to remove it and to replaster damaged walls and ceilings. The Minnesota Supreme Court held that, although the injury to the walls and ceilings could be rectified by removal of the defective plaster, the presence of the defective plaster on the walls and ceilings reduced the value of the building and constituted property damage.²²⁸

In construing liability policies that define "property damage" to mean "physical injury to or destruction of tangible property," however, some courts have strictly enforced the requirement of physical injury.²²⁹ In light of the present CGL policy language, the holding

it suffers actual, physical damage, it would have been relatively simple to include the word 'physical' in its definition.").

²²⁵ See Note, *Liability Coverage for "Damages Because of Property Damage" Under the Comprehensive General Liability Policy*, 68 MINN. L. REV. 795, 803-13 (1984) (notwithstanding judicial authority to the contrary, "a majority of courts and commentators consider loss of use of property [and diminution in value of property] to constitute 'property damage' under the 1966 policy").

²²⁶ See, e.g., *Yakima Cement Products Co. v. Great Am. Ins. Co.*, 22 Wash. App. 536, 544-45, 590 P.2d 371, 376 (1979), *rev'd*, 93 Wash. 2d 210, 218, 608 P.2d 254, 258-59 (1980) (defective concrete wall panels incorporated into a building); *Pittway Corp. v. American Motorists Ins. Co.*, 56 Ill. App. 3d 338, 341, 370 N.E.2d 1271, 1273-74 (1977) (defective valve assemblies used in aerosol cans); *Sturges Mfg. Co. v. Utica Mut. Ins. Co.*, 37 N.Y.2d 69, 72-73, 332 N.E.2d 319, 322, 371 N.Y.S.2d 444, 447 (1975) (defective ski straps incorporated into ski bindings).

²²⁷ 242 Minn. 354, 65 N.W.2d 122 (1954).

²²⁸ *Id.* at 358, 65 N.W.2d at 125.

²²⁹ See, e.g., *Hartford Accident & Indem. Co. v. Pacific Mut. Life Ins. Co.*, 861 F.2d 250, 254 (10th Cir. 1988) (a pre-1973 CGL policy provided coverage for diminution in value of the building onto which the insured installed a defective curtain wall, but the 1973 revisions in the relevant umbrella policy precluded coverage for intangible injuries such as diminution in value); *American Home Assur. Co. v. Libbey-Owens-Ford Co.*, 786 F.2d 22, 24-29 (1st Cir. 1986) (under the 1973 CGL revision, "some physical injury to tangible property [including the property of the insured] must be shown in order to trigger coverage"); *Mraz v. Canadian Univ'l Ins. Co.*, 804 F.2d 1325, 1329 (4th Cir. 1986) (response costs payable under CERCLA are not themselves covered "property damage" under the definition of that term in the 1966 CGL policy, but are instead uncovered "economic loss"); *McCollum v. Insurance Co. of N. Am.*, 132 Ariz. 129, 130-32, 644 P.2d 283, 284-86 (Ct. App. 1982) (a claim for the loss of speculative profits as a result of negligent misrepresentations by the insureds is not a loss arising from "injury to or destruction of tangible property"). *But see* Gordon & Westendorf, *supra* note 2, at 584-86 (noting that liability insurers have met with little success in arguing

in *Hauenstein* has been rejected.²³⁰ In *Wyoming Sawmills, Inc. v. Transportation Insurance Co.*,²³¹ the Oregon Supreme Court held that the requirement of physical injury for property damage negated liability coverage for consequential or intangible losses.²³²

The *Wyoming Sawmills* court found that the incorporation of a defective product into a building did not constitute property damage. The insured manufactured defective two-inch-by-four-inch studs that warped and twisted after being installed in the building. Although the studs had to be replaced, they did not physically damage the rest of the building. The insured tore out and replaced the defective studs and brought an action against its CGL insurer to recover the labor costs associated with this remedial action. Relying on the requirement of "physical injury to tangible property" contained in the 1973 revision to the CGL form, the court declined to follow *Hauenstein*.²³³

in environmental coverage disputes that governmental cost-recovery actions for contamination of soil and water do not constitute claims for "physical injury to or destruction of tangible property"); Aylward, *Covering Asbestos Property Damage Claims and the CGL Policy*, in ASBESTOS PROPERTY DAMAGE CLAIMS 906C K-1, K-6 to K-13, (DEF. RES. INST. COURSEBOOK 1989) (all courts considering the issue have determined, with one exception, that the presence of friable asbestos in buildings constitutes "property damage" under the 1973 CGL definition).

²³⁰ In *Federated Mutual Insurance Co. v. Concrete Units, Inc.*, 363 N.W.2d 751, 756 (Minn. 1985), the Minnesota Supreme Court rejected its own holding in *Hauenstein* as being inapplicable to the revised CGL language requiring physical injury in order to constitute property damage. The insured manufactured defective concrete that was incorporated into a grain elevator. The court found that no property damage occurred, even though the incorporation of the defective concrete decreased the market value of the structure, because it did not cause physical damage to tangible property. *Id.*; see also *Tinker*, *supra* note 223, at 224-25 (the 1973 revised CGL policy definition of "property damage" was intended to bar coverage for intangible injuries such as diminution in value); Note, *supra* note 225, at 810-13 (diminution in value of tangible property does not qualify as "property damage" under the 1973 version of the CGL policy).

²³¹ 282 Or. 401, 578 P.2d 1253 (1978).

²³² *Id.* at 406, 578 P.2d at 1256. Standard property policy forms do not define "physical loss or damage." Therefore, most courts will likely apply the term "physical" in a manner consistent with common usage, and will probably construe it according to its plain and ordinary meaning. Such courts may refer to dictionary definitions of "physical." See, e.g., *American Cas. Co. v. Myrick*, 304 F.2d 179, 182 (5th Cir. 1962) (relying on a dictionary definition to define "explosion"). A leading dictionary defines "physical" as "of or relating to natural or material things as opposed to things mental, moral, spiritual, or imaginary: MATERIAL." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 1706 (1986); see also WEBSTER'S NEW COLLEGIATE DICTIONARY 887 (1984) (defining "physical" to mean "perceptible, especially through the senses"). Such definitions support the view that diminution in value and loss of use should not comprise physical damage for property insurance coverage.

²³³ *Wyoming Sawmills*, 282 Or. at 406, 578 P.2d at 1256. The court reasoned:

The present policy defines property damage as "physical injury to . . . tangible property." Apparently, none of the policies involved in the cases which are the basis for the plaintiff's contention [i.e. the *Hauenstein* progeny] included the word "phys-

The court in *Wyoming Sawmills* ruled that no coverage existed for the insured's labor expense in taking out the defective studs and replacing them with nondefective ones.²³⁴ At the same time, the court held that the costs associated with tearing out other parts of the building in order to replace the studs would be covered by the policy.²³⁵

Decisions awarding coverage in the absence of physical alteration or damage to insured property, however, may not be ignored by the insurer in analyzing contamination claims.²³⁶ One court took the position that a physical loss occurred when tangible property was contaminated and rendered uninhabitable, although there was no palpable physical injury to the insured property. In *Western Fire Insurance Co. v. First Presbyterian Church*,²³⁷ the all risk policy limited the insured's recovery to physical losses. The Colorado Supreme Court held that a direct physical loss occurred when the fire department ordered the insured's church building closed as a health hazard due to contamination by gasoline vapors.²³⁸

ical." The inclusion of this word negates any possibility that the policy was intended to include "consequential or intangible damage," such as depreciation in value, within the term "property damage." The intention to exclude such coverage can be the only reason for the addition of the word.

Id. (emphasis in original).

²³⁴ *Id.* at 406-07, 578 P.2d at 1256.

²³⁵ *Id.* at 407, 578 P.2d at 1256.

²³⁶ See, e.g., *Great N. Ins. Co. v. Dayco Corp.*, 620 F. Supp. 346, 350-51 (S.D.N.Y. 1985) (rejecting the insurer's contention that there was no coverage because the insured suffered a credit loss rather than a physical loss within the policy, where, due to an alleged theft by false pretenses, the insured failed to receive full payment for 12 shipments of goods).

²³⁷ 165 Colo. 34, 437 P.2d 52 (1968).

²³⁸ *Id.* at 39-41, 437 P.2d at 55-56. In deciding that contamination constituted a direct physical loss, the Colorado Supreme Court relied upon *Hughes v. Potomac Insurance Co.*, 199 Cal. App. 2d 239, 18 Cal. Rptr. 650 (1962). A landslide left the insured dwelling precariously overhanging a 30-foot cliff and unsafe to inhabit. *Hughes*, 199 Cal. App. 2d at 243, 18 Cal. Rptr. at 651. Appraisers found that only \$50 of physical damage had occurred to the dwelling itself. *Id.*, 18 Cal. Rptr. at 652. The insureds sued to recover the cost of building a retaining wall and completing a landfill which were both necessary to provide ground support for the dwelling. *Id.*, 18 Cal. Rptr. at 653. As to this latter claim, the California Court of Appeal rejected the insurance company's contention that the loss of ground support did not constitute physical damage to the dwelling within the meaning of a policy insuring against all risks of physical loss of and damage to the insured dwelling. *Id.* at 248, 18 Cal. Rptr. at 655. The court reasoned that: "[d]espite the fact that a 'dwelling building' might be rendered completely useless to its owners, [the insurance company] would deny that any loss or damage had occurred unless some tangible injury to the physical structure itself could be detected [The insureds] correctly point out that a 'dwelling' or 'dwelling building' connotes a place fit for occupancy and a safe place in which to dwell or live." *Id.*; see also *Cypress Grove Townhouse v. Covenant Mut. Ins. Co.*, 242 Cal. Rptr. 708 (Ct. App. 1987). This case has been ordered not to be published in the official reporter and has no precedential value. It is of

Gasoline saturated the soil underneath and surrounding the church building. Vapors contaminated the foundation, halls, and rooms of the church. Ultimately, the vapors rendered the building uninhabitable and the use of the building dangerous. The policy apparently contained no exclusion for losses caused by contamination. The insurance company argued that, although the church suffered a loss of use, no direct physical loss had taken place.²³⁹ The court, however, rejected that theory and affirmed the jury award in an amount necessary to remedy the infiltration and contamination problems.²⁴⁰

By disregarding the policy restriction that physical damage to property must have occurred, courts adopting that view run the risk of expanding coverage beyond what the insured contracted for and purchased. Whether mere loss of use or diminution in value of property, without some identifiable damage, constitutes physical damage for coverage is a question an insurer is entitled to consider when investigating a claim. A valid argument exists that unambiguous policy language requiring physical property damage should be enforced where no visible or palpable damage to property can be established.²⁴¹ This question has not been finally resolved, and the defense of no "physical loss or damage" should not be overlooked when evaluating whether there is coverage for contamination losses.²⁴²

interest for discussion purposes only. In *Cypress Grove*, the court ruled that an all risk policy covered storm damage to sand dunes that formerly provided lateral support and protection from wave activity to a complex of townhouses. 242 Cal. Rptr. at 709. The insurer disputed that it owed coverage for the destruction of the sand dunes and loss of necessary lateral support. *Id.* at 710-11. As a defense, the insurer argued, in part, that it was not obligated under the policy because there had been no direct physical damage to the townhouse structure itself. *Id.* at 714-15. The court rejected the insurance company's position that "the structure cannot be deemed 'damaged' for purposes of property insurance until it becomes so unfit for occupancy, so unsuitable for its intended use, or so uninhabitable that its continued use may be deemed 'dangerous.'" *Id.* at 715. The court ruled that for coverage to exist there need not have been an immediate threat to the dwelling structure and the premises need not have been rendered uninhabitable. *Id.* at 714-15.

²³⁹ 165 Colo. at 38, 437 P.2d at 54.

²⁴⁰ *Id.* at 38-39, 437 P.2d at 55.

²⁴¹ See Miller, *supra* note 221, at 13-18. Miller posits that property insurance should not be construed as insuring the habitability of a residential structure or suitability of a commercial building for its intended purposes where no "physical loss or damage" has taken place. *Id.*

²⁴² A failure to satisfy the requirement of "physical loss or damage" persuaded the Washington Court of Appeals to affirm summary judgment dismissing the insured's claim for insurance coverage under a builders all risk policy. *Nuclear Power Servs., Inc., v. Aetna Cas. & Sur. Co.*, No. 7478-1-III (unpublished opinion) (Wash. Ct. App. May 14, 1987). The policy at issue provided: "This policy insures against all risks of *direct physical loss or damage, and extra expense arising therefrom* as provided herein." *Id.* at 6-7 (emphasis supplied by the court). The insured had contracted to design and fabricate supports and hangers for the

C. Fortuitous Loss

The defense that a loss is not fortuitous²⁴³ is generally applied as a limit to the all risk coverage and is also relevant to named perils policies.²⁴⁴ If an insured knew of the presence of the contaminant

cooling system in a nuclear power plant. The owner was dissatisfied with the work and sued the insured, alleging that some of the hangers and pipe supports were negligently designed and did not meet contract specifications. *Id.* at 2-3. The court agreed with the insurer that its denial of the claim was proper and ruled that:

[T]hese are not direct damages or losses; they are consequential damages arising from intangible injury and are recoverable only after finding a direct physical loss.

Since NPS [the insured] does not claim a direct physical loss, the court's summary judgment dismissing the NPS petition for declaratory relief was proper.

Id. at 7.

The defense of no "physical loss or damage" may become important in deciding claims by insureds seeking coverage for losses arising from the discovery of asbestos in a building. If the insured is making a claim for diminution in value of its property due to the presence of asbestos, there may be no physical damage and no coverage. So long as the asbestos is inert, is not damaging or impairing the structural integrity of the building, is performing its intended function as insulation, fire retardant, or ceiling tile, and the building is habitable, there should be no basis to allege that a physical loss has occurred. If an event takes place that disturbs the asbestos or it flakes and deteriorates, becoming friable, the insured may contend that sufficient physical damage has occurred to trigger coverage. *Paris, supra* note 4, at M-6. *See, e.g., Walters v. Illinois Farmers Ins. Co., No. S 86-310 (N.D. Ind.), reported in 3 Toxics L. Rep. (BNA) 732 (Nov. 9, 1988).* The insured submitted a claim under her homeowners policy alleging that her home and its contents were "rendered valueless and unfit for human use due to the release of asbestos insulation particles caused by the water that had dripped from the basement ceiling." *Id.* The applicable policy required "physical injury to or destruction of tangible property, including loss of its use" for coverage. *Id.* The court, however, rejected the insurer's argument on summary judgment that the insured's claim was really for economic damages. The court was persuaded that the insured had alleged sufficient physical damage in the form of a broken pipe, broken antenna, and water damage. *Id.* No further proceedings in the *Walters* case were apparently reported. The decision points out that the presence or absence of identifiable physical damage should be a pivotal factor in whether a court will allow coverage under a property insurance policy for losses arising from the presence of asbestos in a building.

²⁴³ A fortuitous event is one that is not certain to occur. *Avis v. Hartford Fire Ins. Co.*, 283 N.C. 142, 148, 195 S.E.2d 545, 548 (1973). "Fortuitous" has been defined to mean "occurring by chance without evident causal need or relation or without deliberate intention." *Id.* (quoting WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 895 (1961)). The term has also been defined as "[h]appening by chance or accident," "[o]ccurring unexpectedly, or without known cause," and "[a]ccidental, undesigned, adventitious." BLACK'S LAW DICTIONARY 589 (5th ed. 1979); *see also* BALLENTINE'S LAW DICTIONARY 492 (3d ed. 1969).

²⁴⁴ *See Intermetal Mexicana v. Insurance Co. of N. Am.*, 866 F.2d 71, 74-75 (3d Cir. 1989) ("In addition to the exclusions named in the policy itself, every 'all-risk' contract of insurance contains an unnamed exclusion—the loss must be *fortuitous* in nature.") (emphasis in original); *Atlantic Lines Ltd. v. American Motorists Ins. Co.*, 547 F.2d 11, 12 (2d Cir. 1976) (where policy exclusions are not pertinent, "for recovery under an all risks policy, an insured need demonstrate only that a fortuitous loss has occurred"); Cozen & Bennett, *Fortuity: The Unnamed Exclusion*, 20 FORUM 222 (1985). Cozen and Bennett imply that the doctrine of fortuity is inherent in the concept of a contingent risk required for all risk coverage, though it is not in fact an "exclusion." They point out that the burden of proof of coverage rests with

and was aware of the harmful effect it would have on insured property at the time the policy was purchased, the loss may be nonfortuitous and coverage may be barred.²⁴⁵ An insured bears the burden of proving that a fortuitous loss has occurred.²⁴⁶ Nevertheless, the fortuity doctrine has been transformed in recent years from an emphasis on an objective standard, determining whether the loss was physically inevitable, to a subjective standard, determining whether the insured knew the loss was certain to occur when the policy was issued.²⁴⁷

Courts employing the original fortuity doctrine have emphasized the physical inevitability that a loss would occur. An often-cited case applying an objective standard to assess the inevitability of the loss under the traditional fortuity doctrine is *Greene v. Cheetham*.²⁴⁸ The

the insured. *Id. See, e.g.,* Falcon Products v. Insurance Co. of the State of Pa., 615 F. Supp. 37, 39 (E.D. Mo. 1985) (court rejected the insured's position that the contamination exclusion did not apply when loss was caused by a substance other than nuclear fuel or nuclear waste and that coverage existed "even though the property was already contaminated when occupied and the loss was *certain* to occur") (emphasis in original), *aff'd*, 782 F.2d 779 (8th Cir. 1986); *Mc Quade v. Nationwide Mut. Fire Ins. Co.*, 587 F. Supp. 67, 68 (D. Mass. 1984) (court enforced the contamination exclusion and observed that all risk policies provide "coverage for a variety of risks not ordinarily contemplated, and recovery is generally allowed for all losses of a fortuitous nature, . . . unless the policy contains a specific exclusion precluding coverage"); *cf. Auten v. Employers Nat'l Ins. Co.*, 722 S.W.2d 468, 470 (Tex. Ct. App. 1986), *writ denied*, 749 S.W.2d 497 (Tex. 1988) (no fortuitous event intervened to preclude the application of the contamination exclusion and no coverage existed where losses resulted from the negligent misapplication of pesticides in the insured's house by a professional exterminator).

²⁴⁵ Closely analogous to the policy requirement of fortuity for coverage is the exclusion in Environmental Impairment Liability policy forms for losses due to pre-existing conditions known by the insured at the time the policy was issued. For instance, in *Advanced Micro Devices, Inc. v. Great American Surplus Lines Insurance Co.*, 199 Cal. App. 3d 791, 802, 245 Cal. Rptr. 44, 50 (1988), the court enforced the exclusion for known pre-existing conditions to bar coverage for costs incurred by the insured in removing toxic contamination from the premises of the insured's semiconductor fabrication plant.

²⁴⁶ THOMAS & REED, *supra* note 9, at 123.

²⁴⁷ *Cozen & Bennett, supra* note 244, at 223. *See, e.g.,* Insurance Co. of N. Am. v. United States Gypsum Co., 870 F.2d 148 (4th Cir. 1989). The Fourth Circuit Court of Appeals ruled that a loss due to the substantial earth subsidence that occurred beneath the insured's gypsum processing plant was covered by an all risk policy as a fortuitous event. *Id.* at 153. Although subsidence was certain to occur because of the insured's mining activity and the insured knew that some limited subsidence would occur, the loss was fortuitous because the insured did not expect that a catastrophic subsidence of such great magnitude would take place. *Id.* at 151-52.

²⁴⁸ 293 F.2d 933 (2d Cir. 1961); *see also* Chute v. North River Ins. Co., 172 Minn. 13, 214 N.W. 473 (1927) (loss arising from the cracking of an opal, due solely to its inherent tendency to crack and deteriorate and without any external fortuitous cause, was not covered under an all risk policy of insurance that covered breakage); *Gulf Transp. Co. v. Fireman's Fund Ins. Co.*, 121 Miss. 655, 83 So. 730 (1920) (no coverage under marine policy because no fortuitous

Second Circuit Court of Appeals reversed the trial court judgment rendered in favor of the insureds, who were importers of frozen catfish fillets. The court of appeals remanded for a determination of whether the loss was inevitable, and whether frozen fish that was shipped had become unfit for consumption before the relevant insurance coverage became effective.

The insureds purchased three shipments of frozen fish and had them transported from England to the United States. FDA officials examined the fish upon arrival and condemned the shipment as unfit for human consumption.²⁴⁹ The insureds notified their insurer of the condition of the fish and of the FDA action.²⁵⁰ The insurance underwriters denied liability under the two floating cover policies issued to the insured shipper.²⁵¹

The parties stipulated that the condition of the fish remained unchanged from stowage in the vessel until condemnation.²⁵² The applicable insurance provided coverage for frozen fish shipments "against All and Every Risk whatsoever, howsoever arising Including risks of condemnation by the Authorities under Pure Food Laws irrespective of percentage."²⁵³ The trial court held that coverage was afforded for the condemned fish because the open cover policy form specifically mentioned the risk of condemnation.²⁵⁴

The Second Circuit Court of Appeals reversed, however, because no finding of fact had been made about when the fish became unfit for human consumption.²⁵⁵ The court found that conflicting inferences could be drawn about when the fish spoiled from the evidence stated in the record.²⁵⁶ It concluded that even under an all risk policy the

loss occurred to an insured barge overlaid with oil that leaked oil in calm waters when its seams ruptured due to the weight of the cargo and infirmities of the vessel itself). A highly influential early case on the subject of the fortuity doctrine is *British & Foreign Marine Insurance Co. v. Gaunt*, 2 A.C. 41 (1921) (providing one of the earliest comprehensive statements of the fortuity doctrine and its connection with the nature of all risk coverage). See also *Newton Creek Towing v. Aetna Ins. Co.*, 163 N.Y. 114, 57 N.E. 302 (1900) (coverage for an accident caused by collision was barred because of the insured's intentional misconduct when the insured barge was lost due to the decision of a tugmaster to attempt to force his vessel through an ice field with the barge lashed alongside).

²⁴⁹ 293 F.2d at 934.

²⁵⁰ *Id.*

²⁵¹ *Id.*

²⁵² *Id.* at 937.

²⁵³ *Id.* at 936.

²⁵⁴ *Id.*

²⁵⁵ *Id.* at 937.

²⁵⁶ *Id.*

insurance "would not include an undisclosed event that existed prior to coverage."²⁵⁷

Among the notable American cases enforcing the traditional view of fortuity is *Aetna Insurance Co. v. Sachs*.²⁵⁸ A housebound French poodle was not properly supervised by the insured for an extended period, and the dog committed irreparable damage to carpeting and drapes in about seventy-five to eighty different spots.²⁵⁹ The court ruled that the insurer was not obligated to pay the claim for damage to the carpet because the insureds were guilty of gross negligence and indiscretion in failing to detect the dog's activity earlier.²⁶⁰ The court reasoned that the loss was not fortuitous.²⁶¹

Courts applying the modern rule of fortuity no longer emphasize the objective inevitability of the loss, but focus instead on whether the loss was unplanned and unintentional from the subjective viewpoint of the insured.²⁶² This latter approach does not consider whether from an objective standpoint there was a physical certainty that a loss would occur.²⁶³ This trend fails to take into account the

²⁵⁷ *Id.* The court explained that if the fish was already unfit for human consumption when it was initially shipped, there would have been no contingent risk that was insurable. *Id.*

²⁵⁸ 186 F. Supp. 105 (E.D. Mo. 1960).

²⁵⁹ *Id.* at 107.

²⁶⁰ *Id.* at 108. The court stated that it would have allowed the insured to recover for "two or three" incidents. *Id.* The loss would have been "fortuitous" in that event and the insured would have had an opportunity, through sight or smell, to discover the dog's activity and prevent its repetition. *Id.* A rug specialist testified at trial that the spots would have been easily detectable from the time they dried. *Id.* at 107. He further testified that "one or two" spots could have been easily repaired but that it would have been impossible to match the yarn in the rug in the 75 to 80 soiled locations. *Id.* The court concluded that the insured had not acted reasonably and that his conduct bordered on "wanton recklessness and disregard for which a person should not be rewarded." *Id.* at 108.

²⁶¹ *Id.*

²⁶² See, e.g., *Snapp v. State Farm Fire & Cas. Co.*, 206 Cal. App. 2d 827, 830, 24 Cal. Rptr. 44, 45-46 (1962). The insureds brought a declaratory judgment action under a standard fire policy with an all risk endorsement, asking the court to declare that coverage existed for damage to the insureds' property caused by a landslide. The insurance company defended, in part, by alleging that the earth movement constituting the landslide was inevitable, because of the instability of the landfill on which the insureds' house was built. On appeal from a verdict in favor of the insureds, the California Court of Appeal discounted this defense. The court noted that, given enough information, geologists could probably forecast "the possibility or probability of all earth movements . . . with accuracy." *Id.* (emphasis in original). Further observing that, in hindsight, any movement of land might be said to have been inevitable, the court ruled, "[S]uch 'inevitability' does not alter the fact that at the time the contract of insurance was entered into, the event was only a *contingency* or *risk* that might or might not occur within the term of the policy." *Id.* (emphasis in original). For an insightful discussion of implications on insurance coverage of modern court treatment of the fortuity doctrine, see Cozen & Bennett, *supra* note 244, at 248-55.

²⁶³ Under the traditional rule, when the loss was inevitable under generally recognized

risk-taking element generally contemplated in insurance policies.²⁶⁴ The present tendency of most courts is to construe the phrase "fortuitous event" in the same manner as the term "accident" in a liability insurance policy.²⁶⁵ Under the modern approach, a loss due to the negligence of the insured is considered to be fortuitous.²⁶⁶

A court's inquiry under the modern approach is usually limited to whether a named insured was aware that a loss would occur.²⁶⁷ The majority of cases addressing fortuity have now adopted the definition of "fortuitous event" found in the Restatement of Contracts.²⁶⁸ After restating that an aleatory promise is one conditioned on a fortuitous event, the Restatement defines an aleatory promise indirectly by defining a fortuitous event as "an event which so far as the parties to the contract are aware, is dependent on chance[I]t may

principles of physical and mechanical law, it would not be categorized as a risk that was insurable. The knowledge or ignorance of the insured was irrelevant in making this determination. Cozen & Bennett, *supra* note 244, at 239.

²⁶⁴ See, e.g., *Pfeiffer v. General Ins. Corp.*, 185 F. Supp. 605, 608 (N.D. Cal. 1960) ("A contract of insurance is an agreement to indemnify the insured against loss from contingencies which may or may not occur."). Section 22 of the California Insurance Code provides: "Insurance is a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event." CAL. INS. CODE § 22 (West 1972); see also *Presley v. National Flood Insurers Ass'n*, 399 F. Supp. 1242, 1245 (E.D. Mo. 1975) (loss was not a contingent risk and there was no coverage for property damage due to flooding when the insured purchased a flood policy knowing that gradually rising flood waters were encroaching upon the foundation of his house); *Township of Gloucester v. Maryland Cas. Co.*, 668 F. Supp. 394, 402-03 (D.N.J. 1987) (liability insurer had no duty to defend or indemnify because the insured had actual knowledge that its landfill had contaminated adjoining property before the disputed policy became effective); 1 COUCH ON INSURANCE 2D § 1:5 (1984) ("A contract of insurance is in its nature aleatory . . . in the sense that it depends upon some contingent event against the occurrence of which it is intended to provide, even though such event may never occur."); R. KEETON & A. WIDISS, *INSURANCE LAW: A GUIDE TO FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES, AND COMMERCIAL PRACTICES* 476 (1988) ("In most circumstances, it is contrary to public policy to permit the enforcement of an insurance contract if it would provide indemnification for losses that are not fortuitous.").

²⁶⁵ See *Aetna Ins. Co. v. Sachs*, 186 F. Supp. 105, 108 (E.D. Mo. 1960).

²⁶⁶ See, e.g., *Goodman v. Fireman's Fund Ins. Co.*, 600 F.2d 1040, 1042 (4th Cir. 1979).

²⁶⁷ Cozen & Bennett, *supra* note 244, at 240. Cozen and Bennett point out that most courts now look to the subjective knowledge of the individual insured pursuing the claim. It is not relevant to this determination that a reasonable and prudent person would have known that a loss was imminent. *Id.*

²⁶⁸ The definition contained in Restatement of Contracts § 291 comment a (1932) was substantially carried over into Restatement (Second) of Contracts § 76 comment c (1981), which defines an "aleatory promise" as one conditioned on the occurrence of a fortuitous event. The Restatement (Second) of Contracts notes that an insurance policy is a typical aleatory promise, in which performance is conditional on the happening of a chance event. RESTATEMENT (SECOND) OF CONTRACTS § 379 comment a. See *Compagnie des Bauxites v. Insurance Co. of N. Am.*, 724 F.2d 369, 372 (3d Cir. 1983) (listing cases adopting the definition of fortuity set out in Restatement of Contracts § 291 comment a).

even be a past event, as the loss of vessel, provided that the fact is unknown to the parties."²⁶⁹

In *Compagnie des Bauxites v. Insurance Co. of North America*,²⁷⁰ the Third Circuit Court of Appeals found that the trial court erred in holding that an objectively inevitable loss arising from an unknown design defect was a nonfortuitous event and was not covered. The court of appeals adopted the Restatement definition of "fortuitous event" as the proper standard of review.²⁷¹ Because the insured contended it had no prior knowledge of the design defect,²⁷² the court concluded that the trial court incorrectly granted summary judgment for the insurer.²⁷³

In the context of a present-day claim for property losses due to contamination, an insurer may appropriately consider whether the loss is fortuitous. The loss may not be fortuitous, for example, if an insured knew that a process at its manufacturing plant was producing a toxic waste product likely to result in clean-up costs or property damage.²⁷⁴ Even considering the limitations placed on the doctrine of fortuity by some recent court decisions,²⁷⁵ the re-

²⁶⁹ RESTATEMENT OF CONTRACTS § 291 comment a (1932).

²⁷⁰ 724 F.2d 369, 372 (3d Cir. 1983).

²⁷¹ *Id.*

²⁷² *Id.*

²⁷³ *Id.* at 373. The court discussed and distinguished authority cited by the insurers for the position that a loss caused by a design defect constituted an inevitable certainty that should not be covered by insurance. *Id.* at 372-73. The court noted that cases frequently cited in support of the traditional doctrine of fortuity have been criticized as unpersuasive because: (a) many simply invoke fortuitousness "without any helpful analysis of the meaning of the requirement;" (b) others involve a finding of nonfortuitousness that is "based on the insured's own gross negligence or deliberate risk-taking;" (c) the doctrine is mentioned in dicta unnecessary to the holding of the case; and (d) the decisions emanate from a period in which policy coverage was construed narrowly and strictly as opposed to the broad construction that is the rule in many jurisdictions today. *Id.*

²⁷⁴ For a discussion of the fortuity doctrine in the context of environmental liability claims, see Reeder, *Fortuity: The Unnamed Exclusion in Environmental Claims Under the First Party Policy of Insurance*, reprinted in *Environmental Claims*, *supra* note 4, at 112-19. Reeder takes the position that an insured cannot "in good faith" allege that its loss is fortuitous in an environmental claim if the insured has knowledge prior to the inception of the policy that its property is polluted or has polluted the environment in the regular course of its business without regard for the consequences or has continued to pollute despite notice of damage to the environment. *Id.* at 119.

²⁷⁵ In *Essex House v. St. Paul Marine & Fire Insurance Co.*, 404 F. Supp. 978, 990 (S.D. Ohio 1975), the court imposed an even more restrictive view of fortuity than that normally required under the modern view. It was persuaded that the loss was fortuitous because the insured could not have predicted that a loss would occur during the period of coverage under the specific policy at issue. The court noted, "[O]ne of [the insurer's] . . . claims is that the [covered] face brick was bound to collapse within the policy time limits." *Id.* It went on to observe, however, that "even the defense experts were unable to state that it could be

quirement that a loss must be fortuitous remains a valid criterion for coverage.²⁷⁶

D. Increase of Hazard

The "increase of hazard" defense is conceptually related to the doctrine of fortuity. A policy may be temporarily suspended if an insured volitionally makes a change in conditions on the insured property that creates an enhanced risk of a loss due to contamination. The defense applies to a change in conditions²⁷⁷ that increases the risk of loss resulting from an insured peril²⁷⁸ with the knowledge and

predicted with certainty when the loss would occur." *Id.* Also, the court distinguished the holdings in *Greene v. Cheetham*, 293 F.2d 933 (2d Cir. 1961) and *Chute v. Northern River Insurance Co.*, 172 Minn. 13, 214 N.W. 473 (1927), because in both cases "the loss was brought about by a nonobservable flaw in the insured goods." *Essex House*, 404 F. Supp. at 991. On the facts before it, the court concluded that there was no inherent undetectable defect in the insured face bricking that resulted in its destruction. *Id.*

²⁷⁶ See, e.g., *Home Ins. Co. v. Landmark Ins. Co.*, 205 Cal. App. 3d 1388, 1393, 253 Cal. Rptr. 277, 280 (1988). The court declined to apportion damages between successive property insurers for damages manifested during the period of policy coverage issued by the first insurer. Relying on the "loss in progress rule, i.e., that an insurance company may insure only against contingent or unknown risks," the court ruled that the insurer that covered the risk at the time damage was first discovered was obligated to pay for the entire loss. *Id.* at 1395, 253 Cal. Rptr. at 281-82. There was no duty to apportion the costs of repairing the property damage between the two insurers that had issued successive policies. The second insurer was not required to contribute toward payment of the loss, because "[l]iability will not be imposed under an all-property insurance policy where damages occur and are apparent before the date the policy takes effect." *Id.*, 253 Cal. Rptr. at 282; accord *Avis v. Hartford Fire Ins. Co.*, 283 N.C. 142, 148, 195 S.E.2d 545, 548 (1973). Paint on woodwork and paneling began to blister and peel as the result of a fire, and the insureds sought to recover the expense of removing the paint and repainting. The court ruled the loss was covered, in part, because it "was not inevitable [i.e., did not inevitably occur with the passage of time due to an inherent defect]; it was fortuitous in that it was caused by extraneous events not certain to occur." *Avis*, 283 N.C. at 150, 195 S.E.2d at 549.

²⁷⁷ Many courts have held that only a substantial increase of risk will work a forfeiture of the policy. *Smith v. Peninsular Ins. Co.*, 181 So. 2d 212, 216 (Fla. Dist. Ct. App. 1965); *National Union Fire Ins. Co. v. Richards*, 290 S.W. 912, 916 (Tex. Civ. App. 1927). See generally Annotation, *Change in Purposes for Which Premises Are Occupied or Used as Increase of Hazard Voiding Insurance Coverage*, 19 A.L.R.3d 1336 (1968 & Supp. 1988) (summarizing cases addressing changes in the use of property where the defense of increase of hazard has been asserted).

²⁷⁸ Whether an increase of hazard is substantial or material is generally a factual question to be determined by a court or a jury. See *In-Towne Restaurant v. Aetna Cas. & Sur. Co.*, 9 Mass. App. Ct. 534, 538, 402 N.E.2d 1385, 1388 (1980) (whether gambling activities increased the hazard of loss); *Brooks Upholstering Co. v. Aetna Ins. Co.*, 276 Minn. 257, 262, 149 N.W.2d 502, 506 (1967) (failing to repair a sprinkler system); *Hahn v. Guardian Assur. Co.*, 23 Or. 576, 581-82, 32 P. 683, 685 (1893) (change in the use of the premises from a general store with coal oil lamps to a theater with electric lights).

control of the insured.²⁷⁹ Coverage is suspended until the increased risk is discontinued.²⁸⁰ If a loss occurs while the coverage is suspended due to an increase in hazard, an insured cannot recover for the loss.²⁸¹

The increase of hazard provision forms part of the "New York 165-lines" standard fire policy,²⁸² and is also included as a provision in the statutory fire policies adopted in some states.²⁸³ Although the clause primarily is a factor in fire claims, it can expressly affect coverage for other insured risks.²⁸⁴

²⁷⁹ 8 COUCH ON INSURANCE 2D §§ 37A:274, 37A:279 (1985 & Supp. 1989). Negligence of the insured does not constitute an increase in the hazard unless that negligence results in a change of some duration in the structure, use, or occupancy of the premises. *Id.* § 37A:280. *See, e.g.,* Plaza Equities Corp. v. Aetna Cas. & Sur. Co., 372 F. Supp. 1325, 1331 (S.D.N.Y. 1974); Orient Ins. Co. v. Cox, 218 Ark. 804, 809–10, 238 S.W.2d 757, 759–60 (1951).

²⁸⁰ 8 COUCH ON INSURANCE 2D § 37A:288 (1985 & Supp. 1988); 5 J. APPLEMAN, INSURANCE LAW AND PRACTICE § 2941 (1970 & Supp. 1988). Cases upholding the increase of hazard defense include: Chicago Title & Trust Co. v. Illinois Fair Plan Ass'n, 90 Ill. App. 3d 1061, 1065–66, 414 N.E.2d 205, 208–209 (1980) (insurer entitled to directed verdict on the defense of increase in hazard where a fire destroyed an apartment building in which the utilities and garbage disposal had been discontinued, tenants had vacated the building, and the doors, windows, and furnace were missing); Future Realty, Inc. v. Fireman's Fund Ins. Co., 315 F. Supp. 1109, 1116 (S.D. Miss. 1970) (hazard of fire was greatly increased where the insured permitted the premises to fall into a state of disrepair, failed to observe, inspect, or secure the building, allowed large amounts of debris to accumulate, and failed to prevent the premises from being freely and openly utilized by tramps and vagrants); Simpson v. Millers Nat'l Ins. Co., 175 Colo. 196, 199, 486 P.2d 12, 16–17 (1971) (evidence sustained findings that the increase in hazard of maintaining a cotton processing plant, as opposed to a general warehouse, was substantial and that the hazard was increased within the control and knowledge of the insured).

²⁸¹ *See* Harris Trust & Sav. Bank v. Illinois Fair Plan Ass'n, 68 Ill. App. 3d 934, 937–38, 386 N.E.2d 341, 343 (1979). *See generally* Note, *The Increase of Hazard Clause in the Standard Fire Insurance Policy*, 76 HARV. L. REV. 1472 (1963). The author argues for the application of a standard barring coverage for an increase in hazard only where the change in condition "would materially and substantially enhance the hazard as viewed by a person of ordinary intelligence, care and diligence." *Id.* at 1478. Under a so-called "prudent man standard," the author posits that such a suspension of coverage would require: (1) an identification of the risk for which the hazard of loss has been increased; and (2) a determination of whether the increase of risk of loss is a substantial one under the circumstances. *Id.* The author argues that the adoption of such a standard for assessing the impact of the increase of hazard clause would minimize uncertainty for the insured and the insurer. *Id.* at 1480.

²⁸² In 1918, in the interest of policy uniformity and consistency of coverage interpretation, the National Convention of Insurance Commissioners recommended that states adopt the revised standard form of fire policy that had already been approved by the New York State Legislature. HUEBNER, BLOCK & CLINE, *supra* note 5, at 4. The 1918 New York Standard Policy, first revised in New York in 1943, comprised 165 lines of numbered text and is commonly referred to in the insurance industry as the "New York 165-lines" form. *See id.* at 24, 29 & nn.9–10. For the full text of the New York 165-lines form, see *id.* at 27. Lines 31–32 of the New York 165-lines form provide that the insurer will not cover a loss that occurs "while the hazard is increased by any means within the control or knowledge of the insured." *Id.* at 23, 27.

²⁸³ *See, e.g.,* OR. REV. STAT. § 743.624 (1987) (conditions suspending insurance).

²⁸⁴ *See* 8 COUCH ON INSURANCE 2D § 37A:293 (1985 & Supp. 1989).

Whether there has been an increase in hazard must be determined by a comparison with the conditions existing at the time the policy was written.²⁸⁵ Unlike the fortuity doctrine, the increase of hazard provision applies only to future changes and not to conditions existing when the policy was issued.²⁸⁶ The provision is not an exclusion, but is a condition subsequent suspending coverage.²⁸⁷ The burden is on the insurer to prove the increase in the risk of loss in order to sustain a denial of coverage.²⁸⁸

A split of authority exists on whether the increase of hazard must proximately cause the loss in order for the insurance company to rely on the defense. The majority view holds that the increase in hazard need not result in a loss to void coverage.²⁸⁹ A minority of states holds that the increase in risk of loss must cause or contribute to the loss to relieve the insurer of liability.²⁹⁰ In *Good v. Continental Insurance Co.*,²⁹¹ the court followed the majority rule and held that if an increase in risk is permanent and continuous it voids coverage under the policy, even though it does not produce a loss.²⁹² The contrary view was expressed in *Hawkeye Chemical Co. v. St. Paul Fire & Marine Insurance Co.*²⁹³ Under either approach, if the in-

²⁸⁵ See, e.g., *Future Realty, Inc. v. Fireman's Fund Ins. Co.*, 315 F. Supp. 1109, 1114 (S.D. Miss. 1970); *Industrial Dev. Ass'n v. Commercial Union Surplus Lines Ins. Co.*, 222 N.J. 281, 294, 536 A.2d 787, 793-94 (1988).

²⁸⁶ See 8 COUCH ON INSURANCE 2D § 37A:288 (1985 & Supp. 1989); see also *supra* note 280.

²⁸⁷ See *id.*

²⁸⁸ *Commercial Union Ins. Co. v. Stanmike Inv. Co.*, 475 S.W.2d 295, 297-98 (Tex. Civ. App. 1971); 8 COUCH ON INSURANCE 2D § 37A:305 (1985 & Supp. 1989).

²⁸⁹ 5 J. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 2941 (1969 & Supp. 1989); 8 COUCH ON INSURANCE 2D § 37A:278 (1985 & Supp. 1989); Note, *supra* note 281, at 1474-75 & nn.20-21. See, e.g., *Quam v. General Accident Ins. Co. of N. Am.*, 411 N.W.2d 270, 273 (Minn. Ct. App. 1987).

²⁹⁰ 8 COUCH ON INSURANCE 2D § 37A:278 (1985 & Supp. 1989). See, e.g., *American Gen. Ins. Co. v. Bell*, 116 S.W.2d 877, 880 (Tex. Civ. App. 1938).

²⁹¹ 277 S.C. 569, 291 S.E.2d 198 (1982).

²⁹² *Id.* at 572, 291 S.E.2d at 199. In *Good*, the insured permanently installed a distillery in his house after the insurance policy became effective. The use of the dwelling to manufacture liquor and to store mash and flammable liquids in large quantities substantially increased the hazard assumed under the policy. The court enforced the increase of hazard clause to deny coverage and agreed that it was "immaterial whether the use of the premises for the manufacture of illegal whiskey caused or contributed to the cause of the fire." *Id.*; see also *Charles Stores, Inc. v. Aetna Ins. Co.*, 428 F.2d 989, 993 (5th Cir. 1970) (observing that "the insurer may assert the increase in hazard defense even though the loss was not occasioned by the increase in hazard").

²⁹³ 510 F.2d 322 (7th Cir.) (applying Iowa law), *cert. denied*, 421 U.S. 965 (1975). The insured operated a nitrogen fertilizer plant, and was insured under policies providing that the insurers "shall not be liable for loss incurring . . . while the hazard is increased by any means within the control or knowledge of the insured." *Id.* at 323. During the period the policies were in effect, the risk of fire at the plant was increased when gas leaked from a "cold exchanger," a multi-layered pressure vessel. *Id.* The cold exchanger at the insured's plant exploded, causing

creased risk proximately causes the loss, even an occasional or temporary increase of risk should be sufficient to void the policy.²⁹⁴

If an insured seeks to recover for a contamination loss under a policy containing an increase of hazard clause, an insurer is entitled to consider whether coverage has been suspended by operation of that provision where circumstances warrant it.²⁹⁵ There may be no coverage where an insured is an industrial concern that knowingly alters its manufacturing processes in a manner that heightens the risk of a release of toxic wastes. Likewise, there may be no coverage if an insured is a manufacturer who undertakes for the first time, during the policy period, the production of a line of products that generate toxic wastes as a by-product. In either instance, if there is an accidental release of pollutants, there may be no coverage for a resulting property damage claim for contamination losses because an insured has knowingly increased the risk of such losses in a manner within its control.

E. Covered Property

Commercial and homeowners policies insure only the real and personal property designated in the declarations. Accordingly, an insured must have an insurable interest in the property at the time the loss occurred.²⁹⁶ In *Falcon Products, Inc. v. Insurance Co. of the State of Pennsylvania*,²⁹⁷ there was no coverage for a loss arising from the retrieval and disposal of contaminated metal table bases when the irradiated metal was contaminated before ownership passed to the insured.²⁹⁸ Because the contaminated metal was not covered property when the loss occurred, the all risk insurance policy did not apply.²⁹⁹ This case illustrates the importance of evaluating

substantial property damage. *Id.* at 324. Contending that the explosion was causally related to the leak, the insurers denied coverage. The insured sued, and the jury found that, although the insured increased the risk of loss in a manner within its knowledge and control, the increase in hazard did not contribute to the explosion. *Id.* On appeal, the Seventh Circuit Court of Appeals, applying Iowa law, held that the increase of hazard defense "is inoperative in relation to the facts of this case." *Id.* at 327.

²⁹⁴ See generally 8 COUCH ON INSURANCE 2D § 37A:278 (1985 & Supp. 1989); Note, *supra* note 281, at 1474-75 & nn.20-21.

²⁹⁵ Arguably, an application of the increase of hazard defense should suspend coverage if an insured was involved in illegal activity on the property or knew in advance that the property was going to be used for an illegal purpose. See *supra* note 68.

²⁹⁶ See 3 COUCH ON INSURANCE 2D § 24:12 (1984 & Supp. 1989); 4 J. APPLEMAN, INSURANCE LAW AND PRACTICE § 2121 (1969 & Supp. 1989).

²⁹⁷ 782 F.2d 779 (8th Cir. 1986), *aff'g* 615 F. Supp. 37 (E.D. Mo. 1985).

²⁹⁸ *Id.* at 779; 615 F. Supp. at 39.

²⁹⁹ 615 F. Supp. at 39.

when the loss occurred before making the determination of whether or not there is coverage.

In *Falcon Products*, the Difference in Conditions property policy provided: "This policy insures against all risks of direct physical loss or damage to the property *covered* hereunder from any external cause . . . except as herein excluded and subject to all other provisions of the policy."³⁰⁰ The property covered under the policy included: "[t]he interest of the insured in personal property owned or [thereafter] acquired, all while on premises *owned, leased or occupied by the insured*, together with its interest in personal property of others in the insured's custody."³⁰¹ Among the perils excluded were loss or damage caused by or resulting from contamination.

The insured's subsidiary purchased the contaminated scrap metal and then melted it at its foundry to form the metal into table base castings.³⁰² The table bases were sold to the parent corporation and distributed to customers.³⁰³ After the contamination was discovered, the table base castings were retrieved from the customers and disposed of by the insured.³⁰⁴ The policyholder incurred major expenses and sustained substantial losses, for which it submitted a property insurance claim.³⁰⁵

To circumvent the exclusion for contamination losses, the insured argued that its loss was not the proximate result of contamination.³⁰⁶ The insured claimed that the "efficient physical" cause of the loss was the negligent conduct of the person(s) responsible for the release of radioactive pellets that contaminated the scrap metal.³⁰⁷ The trial court rejected the insured's interpretation of the contamination exclusion,³⁰⁸ but did not rule on the insured's view that the loss was covered as third-party negligence.³⁰⁹ In its order granting summary judgment for the insurance company the trial court ruled, and the

³⁰⁰ *Id.* at 38 (emphasis in original).

³⁰¹ *Id.* (emphasis in original).

³⁰² *Id.*

³⁰³ *Id.*

³⁰⁴ *Id.*

³⁰⁵ *Id.*

³⁰⁶ *Id.* at 39.

³⁰⁷ *Id.*

³⁰⁸ *Id.* at 38-39. The district court found that the metal was "contaminated" within the meaning of the policy exclusion for "contamination." *Id.* On appeal, it was held that the contamination exclusion provided an independent basis for denial, apart from the court's finding that the metal was not "property covered" by the policy at the time of the loss or damage. 782 F.2d 779, 779-80.

³⁰⁹ 615 F. Supp. at 39.

Eighth Circuit Court of Appeals agreed, that the insured had not sustained an insurable loss to *covered* property.³¹⁰

An insurer should evaluate carefully whether the contamination-related loss has occurred to property satisfying the definition of "covered property" under the policy. As part of this evaluation, an insurer should analyze when the loss occurred. Even if caused by an insured peril, there is no coverage for damage to contaminated property that does not constitute covered property at the time of the loss. With that consideration in mind and to clarify coverage for contamination losses, recent revisions to standard forms of property insurance policies have expressly excluded certain additional types of property from the definition of covered property.

IV. SPECIFIC EXCLUSIONS IN STANDARD PROPERTY POLICIES

Apart from the defense that a claim falls outside the intended scope of insurance coverage, a specific exclusion from coverage may apply. An insurance company is entitled to enforce exclusions when a conscientious investigation of a loss establishes that the efficient or proximate cause of the loss was an excluded peril.

In *Mc Quade v. Nationwide Mutual Fire Insurance Co.*,³¹¹ the court granted the insurer's motion to dismiss the insured's action to recover for the insurer's alleged unfair and deceptive business practices.³¹² The insured claimed the insurance company acted in an unfair and deceptive manner in relying on the contamination exclusion to deny coverage when the all risk policy otherwise granted very broad coverage.³¹³ The court concluded that the policy terms were unambiguous and that the insured's claim was clearly barred by the terms of the policy.³¹⁴ The insured's complaint was dismissed

³¹⁰ 782 F.2d at 779; 615 F. Supp. at 39. The district court explained:

[T]he policy provided insurance (subject to exclusions) only against all risks of direct physical loss or damage to property *covered* thereunder, namely, the interest of [the insured] Falcon in property *owned* or in Falcon's custody on Falcon's premises *at the time of the loss*. It follows as a matter of law and fact that irrespective of what or who caused the scrap metal to be contaminated, plaintiffs could not have sustained an insurable loss based on negligent conduct of third persons which occurred on premises in which Falcon had no interest and which resulted in contaminating property in which Falcon *then* had no interest whatever.

615 F. Supp. at 39 (emphasis in original).

³¹¹ 587 F. Supp. 67 (D. Mass. 1984).

³¹² *Id.*

³¹³ *Id.* at 68.

³¹⁴ *Id.*

for failure to state a claim because the insurance company acted properly in enforcing the contamination exclusion.³¹⁵

In most jurisdictions, the insurer has the burden of proof of establishing that a given exclusion bars coverage for a claim.³¹⁶ The following exclusions are among the exceptions to coverage that an insurance company should validly consider in assessing the merits of a contamination claim.

A. No Coverage for Losses to Land or Water

Losses resulting from contamination of land ordinarily fall outside the scope of coverage or are expressly excluded. No standard property forms specifically include land in the definition of "covered property."³¹⁷ A currently used ISO homeowners policy form excludes coverage for land, including land on which the dwelling is located.³¹⁸ The recently promulgated ISO endorsement clarifying coverage for pollutants in commercial risks also contains an express exclusion of land from covered property.³¹⁹

There is a dearth of reported authority interpreting a policy exclusion of coverage for land. Cases addressing related issues may be relied upon by insureds, however, in claims that should trigger the land exclusion.³²⁰ In *Gibson v. Secretary of United States Department*

³¹⁵ *Id.*

³¹⁶ See THOMAS & REED, *supra* note 9, at 123; 13A COUCH ON INSURANCE 2D § 48:142 (1982 & Supp. 1988); 21 J. APPLEMAN, INSURANCE LAW AND PRACTICE § 12245.25 (1980 & Supp. 1988). In Texas, however, when an insurer alleges that an exclusion applies, the *insured* bears the burden of establishing that its loss did not come within the exclusion. See *Travelers Indem. Co. v. McKillip*, 469 S.W.2d 160, 162 (Tex. 1971); TEX. R. CIV. P. ANN. r. 94 (Vernon 1979 & Supp. 1988).

³¹⁷ MALLIN, *supra* note 4, at 45.

³¹⁸ HO-3 (Ed. 04 84) (SECTION 1—PROPERTY COVERAGES, Coverage A—Dwelling).

³¹⁹ CP 01 86 04 86. See also the ISO Building and Personal Property Coverage Form (CP 0010 1185), which, under the section "Property Not Covered," excludes land, "including land on which the property is located." The special Multi-Peril Forms do not contain an express exclusion for land. See MP 00 90 (Ed. 07 77), MP 00 13 (Ed. 10 83); MP 00 14 (Ed. 10 83). Indeed, the latter two forms each provide named peril coverage of up to \$1,000 for exterior trees, shrubs, and plants (limited to \$250 for each tree, shrub, or plant). The Building and Personal Property Coverage Form CP 00 10 11 85 includes coverage on a named peril basis of up to \$1,000 for trees, shrubs, and plants (limited to no more than \$250 for each tree, shrub, or plant) and excludes lawns and crops. The MP 00 13 excludes coverage for lawns, while the MP 00 14 excludes coverage for lawns and crops. Forms CP 00 10 11 85 and MP 00 13 (Ed. 10 83), however, exclude the "cost of excavations, grading or filling."

³²⁰ An insurer unsuccessfully moved for summary judgment based on the exclusion of coverage for "loss or damage to land" in *St. Paul Fire & Marine Insurance Co. v. Protection Mutual Insurance Co.*, 664 F. Supp. 328 (N.D. Ill. 1987). As the direct result of the fire, PCB mixed with water and was discharged onto the land outside the insured building. *Id.* at 331. The court declined to rule in favor of the insurer because the available evidence indicated that

of *Housing and Urban Development*,³²¹ the policy insured a dwelling against direct loss by flood, but excluded land values as "Property Not Covered."³²² Under "Property Covered," the policy specified "One Family Dwelling" and "Household Goods."³²³ The federal district court ruled that there was coverage for the insured's loss of a dwelling because the insureds suffered a loss of use of the residence due to periodic flooding. The court characterized this loss as the loss of a property right associated with their dwelling rather than with the land on which it sat. In reaching its decision, the court agreed that only the dwelling and its contents were covered and not the surrounding land.³²⁴

Some courts have found land to be covered when an insured dwelling is threatened structurally because the land beneath it has become unstable. In homeowners coverage disputes, some California courts have held that damage to the land underlying an insured structure falls under the term "dwelling" and therefore is covered, or, alternatively, that the insurer was liable for land stabilization costs necessary to provide lateral support to a structure.³²⁵

Insureds may rely upon the above case law in claims under homeowners policies for the cleanup of pollutants from residential property where a dwelling structure is rendered uninhabitable. Such judicial authority should not be persuasive in interpreting the new policy language, however, because the policies involved in the earlier cases did not expressly exclude land from the definition of covered property. Further, such authority is readily distinguishable and

the insured also incurred unsegregated costs for the removal of PCB contamination inside its plant. *Id.* at 333 n.8. There was no evidence presented about how much money was spent on the removal of PCB from the land outside the insured's building. In dicta, however, the court stated that it would have been willing to enforce the land exclusion had the facts warranted it. *Id.*

³²¹ 479 F. Supp. 3 (M.D. Pa. 1978).

³²² *Id.* at 6.

³²³ *Id.*

³²⁴ *Id.* at 5-6.

³²⁵ See, e.g., *Pfeiffer v. General Ins. Corp.*, 185 F. Supp. 605 (N.D. Cal. 1960) (applying the common-law doctrine that a dwelling includes the curtilage and finding that repairs to the structure alone would not cure the damages until earth movement under the house was stabilized); *Hughes v. Potomac Ins. Co.*, 199 Cal. App. 2d 239, 247-48, 18 Cal. Rptr. 650, 653-55 (1962) (followed the *Pfeiffer* case in holding that the policy insured against all physical loss to the dwelling or dwelling building and did not expressly provide that ground underlying the dwelling was to be excluded from coverage); *Cypress Grove Townhouse Project Comm. v. Covenant Mut. Ins. Co.*, 242 Cal. Rptr. 709, 713 (1987) (under a policy insuring "buildings and/or structures in all parts," the insurer was obligated to pay for necessary measures to provide the same degree of lateral support and protection from ocean waves as existed prior to the erosion precipitated by ocean storms).

should not apply to claims under commercial property policies for losses due to land contamination. In the absence of reported cases addressing a property insurer's policy obligations for the cleanup of contaminants from land, a claim for losses due to land contamination should fall outside the policy coverage unless there is an express reference in the policy that land qualifies as covered property. Where there is an express exception of coverage for land, the argument that there is no coverage to remove contaminated land is even stronger.

There also should be no insurance for water as covered property under the latest ISO endorsement.³²⁶ The newly released endorsement entitled "Changes—Pollutants" (CP 01 86 04 86) amends the Building and Personal Property Coverage Form (CP 00 10 11 85) to exclude water as covered property.³²⁷ The intent behind this clarification is to exclude all coverage for water within or upon the ground, as well as for water constituting personal property, such as that within any type of above-ground container.³²⁸

³²⁶ At least one court has reportedly allowed insureds to recover against their property insurers for their bad-faith failure to pay claims under homeowners policies due to damages caused by groundwater contamination. *Potter v. Fire Ins. Exch.*, No. 606612 (Cal. Super. Ct., Santa Clara County, July 8, 1988), reported in 3 *Toxics L. Rep.* (BNA) 308 (1988). The insureds submitted claims to recover under their homeowners policies on the theory that contamination of their groundwater rendered their property uninhabitable. The insurer denied the claims in reliance on the contamination exclusion in the policies. After denying the claims, the insurers obtained the opinion of an outside law firm that there was likely coverage under California's concurrent causation doctrine as it was applied at the time. One of the insurers did not contest its liability under its policy and presented evidence at the trial that the claim was supposed to have been paid but was not because of an oversight. *Id.*

The outcome of the insureds' claims in *Potter* would likely be very different if that case were decided today under a revised standard policy form and pursuant to the present law of California on concurrent causation. Most policies now contain "anti-concurrent causation" language. See *supra* note 29 and accompanying text; see also Glad & Barnes, *supra* note 1, at 8 (authors observe that property insurance "was never contemplated to extend to groundwater and its required cleanup is beyond the scope of first-party coverage").

³²⁷ The new endorsement modifies the Standard Commercial Property Form by providing in relevant part:

CHANGES—POLLUTANTS

This endorsement modifies insurance provided under the following:

A. The changes below apply to the following forms:

BUILDING AND PERSONAL PROPERTY COVERAGE FORM

CONDOMINIUM ASSOCIATION COVERAGE FORM

CONDOMINIUM COMMERCIAL UNIT-OWNERS COVERAGE FORM

BUILDERS RISK COVERAGE FORM

TOBACCO SALES WAREHOUSES COVERAGE FORM

1. Under PROPERTY NOT COVERED the following is added:

Covered Property does not include water.

Copyright, ISO Commercial Services, Inc., 1986. See MALLIN, *supra* note 4, at 189.

³²⁸ MALLIN, *supra* note 4, at 96 n.145.

B. Contamination Exclusions

Many standard all risk property forms have traditionally contained an exclusion for losses caused by contamination.³²⁹ This exclusion has appeared in the policy form along with other excluded causes of loss. It has been the focus of relatively little attention, however, compared with the other exclusions that have been invoked more frequently.³³⁰ In recent years, though, the public has become more aware of the deleterious effects of toxic waste, asbestos, and other harmful pollutants. Given the high cost of cleaning up these substances, insurance companies can anticipate a dramatic increase in property claims by insureds aggressively pursuing coverage.³³¹ To prepare for such claims arising in the future, the insurance industry has modified the standard contamination exclusion to clarify the policy intent.

Decisions from various jurisdictions interpreting the standard contamination exclusion³³² have applied inconsistent reasoning. On the

³²⁹ The prevalent commercial form used to insure structures and personal property, the CP 10 30 11 85, applies an exclusion for contamination losses to both real and personal property claims. A widely used standard commercial property form primarily intended to insure buildings, the MP 00 13 (Ed. 10 83), does not contain an express exclusion for losses caused by contamination. A commercial policy form used to insure personal property, the MP 00 14 (Ed. 10 83), however, does contain an express exclusion for contamination losses. Similarly, between the All Risk Commercial Fire Policy forms, the CF 00 13 (Ed. 10 83) (Structures), and CF 00 14 (Ed. 10 83) (Personal Property), only the personal property coverage form contains a specific exclusion for contamination. Standard Named Perils Coverage forms traditionally have not included a contamination exclusion.

³³⁰ Butler, *supra* note 4, at 368. For a review of judicial treatment of the contamination exclusion, see Annotation, *Property Damage Insurance: What Constitutes "Contamination" Within Coverage, or Exception or Exclusion from Coverage*, 96 A.L.R.2d 1360 (1964) and A.L.R.2d Later Case Service (1983 & Supp. 1989).

³³¹ See *Falcon Products v. Insurance Co. of the State of Pa.*, 615 F. Supp. 37, 39 (E.D. Mo. 1985), *aff'd*, 782 F.2d 779 (8th Cir. 1986). The insured tried to recover for losses it sustained in retrieving and disposing of irradiated metal table base castings. The relevant all risk policy contained an exclusion for loss or damage caused by or resulting from "contamination." *Id.* at 38. The insured argued that, when read in conjunction with the policy's nuclear exclusion clause, the contamination exclusion did not apply to contamination resulting from contact with a radioactive substance other than nuclear fuel or nuclear waste. The court analyzed the insured's contentions and ruled that "[n]o such intent is here manifested." *Id.* at 39.

³³² Standard all risk forms containing an express exclusion for contamination losses have generally grouped contamination along with a lengthy list of other excluded loss causes. For example, the standard homeowners form HO-3 (Ed. 03 83) provided coverage for a "direct physical loss to property . . . except . . . wear and tear; marring; deterioration; inherent vice; latent defect; mechanical breakdown; rust; mold; wet or dry rot; contamination." A commercial form used to insure personal property, the MP 00 14 (Ed. 10 83), states that it does "not insure under this form against loss caused by . . . rust, mold, wet or dry rot, [or] contamination." The Standard Building and Personal Property Coverage Form (CP 00 10 11 85)

one hand, many courts have enforced the exclusion regardless of the cause of the contamination when the insured property was in a contaminated state. On the other hand, if the cause of the contamination is found to be a covered peril, some courts have refused to apply the contamination exclusion.³³³

1. "Contamination" Defined

Although many homeowner and commercial policies contain an exclusion for losses caused by "contamination," the term is not usually defined in the policy. A leading judicial definition has referred to dictionary definitions of the term and has focused on the condition of the insured property. In *American Casualty Co. v. Myrick*,³³⁴ the Fifth Circuit Court of Appeals held that "'Contamination' connotes a condition of impurity resulting from mixture or contact with a foreign substance."³³⁵

Other cases have recognized that property can be contaminated when a foreign substance merely reduces its usefulness without affecting its original physical characteristics.³³⁶ Under this view, contamination means "to make unfit for use by introduction of an unwholesome or undesirable element," and implies "intrusion of or contact with an outside source as its cause."³³⁷ In *Hi-G, Inc. v. St. Paul Fire & Marine Insurance Co.*,³³⁸ the First Circuit Court of

provides, however, that the insurer "will not pay for loss or damage caused by or resulting from . . . [r]elease, discharge or dispersal of contaminants or pollutants."

³³³ For an overview of concurrent causation analysis employed in states that have adopted the doctrine, see *supra* notes 14-40 and accompanying text.

³³⁴ 304 F.2d 179 (5th Cir. 1962).

³³⁵ *Id.* at 183; see also *Auten v. Employers Nat'l Ins. Co.*, 722 S.W.2d 468, 469 (Tex. Ct. App. 1986) (applying the *Myrick* definition), *writ denied*, 749 S.W.2d 497 (Tex. 1988); *Raybestos-Manhattan, Inc. v. Industrial Risk Insurers*, 289 Pa. Super. 479, 482, 433 A.2d 906, 907-08 (1981) (citing with approval the definition of "contamination" stated in *Myrick*).

³³⁶ In *Hartory v. State Automobile Mutual Insurance Co.*, No. 1395 (Ohio Ct. App. June 24, 1988), the court applied a dictionary definition and interpreted contamination as meaning "to render unfit for use by the introduction of unwholesome or undesirable elements." *Id.* (citing WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY (1981)). By so doing, the court denied coverage for a homeowner's claim to recover losses arising when methane gas from a nearby landfill permeated the insured's home and water well. The Ohio Court of Appeals ruled that the methane gas rendered the insureds' home and well unfit for use, but that the policy's contamination exclusion precluded coverage. *Id.*; see also *Falcon Products v. Insurance Co. of the State of Pa.*, 615 F. Supp. 37 (E.D. Mo. 1985) (exposure to a radioactive substance, which was later incorporated into the insured's products, destroyed the products' usefulness and they were contaminated, although there was no visible defect), *aff'd*, 782 F.2d 779 (8th Cir. 1986).

³³⁷ *Hi-G, Inc. v. St. Paul Fire & Marine Ins. Co.*, 283 F. Supp. 211, 213 (D. Mass. 1967), *aff'd*, 391 F.2d 924 (1st Cir. 1968).

³³⁸ 391 F.2d 924 (1st Cir. 1968).

Appeals held that "while the introduction of an . . . [undesirable] element may change the product itself, it is not essential to contamination that it do so."³³⁹ The district court in *Hi-G* made this same point by noting that a "thing may be contaminated when it is corrupted by the touch or contact of an external object, even though it does not itself change in form or substance."³⁴⁰ Under this reasoning, no palpable physical transformation in the substance or appearance of the covered property is required to constitute a loss due to the contamination exclusion.

Potential fact scenarios triggering a claim under property insurance to recover for contamination losses probably are unlimited.³⁴¹ On industrial property, for example, soil contamination by common industrial substances is likely and may result in groundwater contamination. Agricultural properties also may become contaminated by pesticides.

Common sources of contamination at commercial properties include: asbestos (widely used as sprayed-on insulation for structural steel and in ceiling tiles in new buildings from the 1950's to the early 1970's); PCBs (once widely used in electrical transformers and other electrical equipment); leakage of product residues (for example, a large concentration of sugar from a confectionary plant leaking into a nearby pond on adjacent land); and underground storage tanks (for example, abandoned heating oil tanks). Residential property may become contaminated by a number of sources, including the overuse of pesticides, leakage of hazardous waste or penetration of fumes from adjoining property, and asbestos.

Federal, state, and local laws in some instances regulate acceptable levels of certain contaminants and mandate remedial cleanup of hazardous substances where the presence of such substances is unsafe or exceeds established safety levels.³⁴² Under the definitions

³³⁹ *Id.* at 925. But see *McConnell Constr. Co. v. Insurance Co. of St. Louis*, 428 S.W.2d 659, 661 (Tex. 1968). The Texas Supreme Court held that damage to metal in a newly constructed house, due to an application of muriatic acid to floors, was not caused by contamination, but resulted from corrosion. *Id.* The court relied on the definition of contamination in *American Casualty Co. v. Myrick*, 304 F.2d 179 (5th Cir. 1962), denoting a state of impairment or "an impure mixture." *McConnell*, 428 S.W.2d at 661. The *McConnell* court did not consider or note the "unfit for use" approach employed by the court in *Hi-G* to define contamination.

³⁴⁰ 283 F. Supp. at 213 n.1.

³⁴¹ For a discussion of hypothetical situations illustrating potential contamination losses giving rise to claims under a property policy, see MALLIN, *supra* note 4, at 6-9, 112-23.

³⁴² Major federal statutes governing environmental conditions include: The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA or Superfund), 42

addressed above, contaminated property can be almost any property made impure or rendered unfit for use or occupancy by the introduction of a hazardous substance.

2. Case Authority Enforcing the Contamination Exclusion

Many courts have found no coverage for losses arising from contamination damage to property because the relevant all risk policy contained a contamination exclusion. The following cases highlight that claims for losses caused by contamination are not properly covered under such insurance policies.

a. *The Auten Case*

A recent case enforcing the contamination exclusion and denying coverage is *Auten v. Employers National Insurance Co.*³⁴³ The *Auten* court declined to follow the decision in *Raybestos-Manhattan, Inc. v. Industrial Risk Insurers*,³⁴⁴ a case holding that there was coverage for a loss resulting from third-party negligence even though the property damage was caused by "contamination," which was a specifically excluded peril.³⁴⁵ The *Auten* court expressly rejected the insureds' argument that concurrent causation analysis applied,³⁴⁶ and held that "the policy excludes all losses caused by contamination regardless of the cause of the contamination."³⁴⁷

In *Auten*, the insureds contracted with an exterminating service to have a portion of their residence sprayed with an insecticide.³⁴⁸

U.S.C. §§ 9601-9657 (1982); Superfund Amendments and Reauthorization Act (SARA), 42 U.S.C. §§ 9605-9675 (Supp. V 1987); Resource Conservation and Recovery Act (RCRA), 42 U.S.C. §§ 6901-6975 (1982 & Supp. V 1987); Clean Water Act, 33 U.S.C. §§ 1251-1376 (1982 & Supp. V 1987); and HWSE. Many state governments have also passed laws regulating hazardous substances and mandating the cleanup of such substances. See, e.g., The New Jersey Environmental Cleanup Responsibility Act (ECRA), N.J. STAT. ANN. § 13:1K-6 to :1K-35 (West Supp. 1989). A discussion of the regulatory scheme imposed by the respective acts noted above is beyond the scope of this Article.

³⁴³ 722 S.W.2d 468 (Tex. Ct. App. 1986), writ denied, 749 S.W.2d 497 (Tex. 1988). After hearing oral argument, the Texas Supreme Court determined that the writ of error had been granted improvidently and ultimately denied review on May 11, 1988. *Auten*, 749 S.W.2d at 497.

³⁴⁴ *Raybestos-Manhattan, Inc. v. Industrial Risk Insurers*, 289 Pa. Super. 479, 433 A.2d 906 (1981). For a discussion of *Raybestos-Manhattan*, see *supra* notes 30-40 and accompanying text.

³⁴⁵ *Raybestos-Manhattan*, 289 Pa. Super. at 483, 433 A.2d at 908.

³⁴⁶ 722 S.W.2d at 470-71.

³⁴⁷ *Id.* at 468.

³⁴⁸ *Id.* at 468-69.

After the exterminator completed his treatment, the insureds discovered that their furniture was covered with an oily film, their carpet was stained, and a strong chemical odor pervaded their home.³⁴⁹ The insureds steam-cleaned the affected portion of the carpeting and thoroughly cleaned and ventilated their house. Nevertheless, the stain, odor, and oily film remained. The insureds also began to experience symptoms of physical illness.³⁵⁰

When the property insurer denied their insurance claim for the alleged resulting losses, the insureds sued to recover the loss in value to their home and their increased living expenses.³⁵¹ The applicable all risk policy provided that it did "not cover . . . [l]oss caused by contamination."³⁵² The property insurer defended by relying on the contamination exclusion, contending the peril that caused the loss was excluded from coverage by the terms of the policy.

Evidence produced at trial established that the insureds' house contained an above-normal level of Dursban, an oil-based pesticide, which had been applied by fogging rather than spraying. There was also medical testimony that Dursban caused the physical symptoms that the insureds suffered.³⁵³ The only remedy was to eliminate the insureds' exposure to the chemical. Before the insureds' suit against their insurer could be finally adjudicated, the insureds settled with the exterminator.³⁵⁴ After the jury found coverage and returned a verdict for the insureds, the trial court awarded the insureds only their attorney fees.³⁵⁵

To surmount the insurer's contamination exclusion defense, the insureds argued on appeal that the ultimate cause of their loss was the negligence of the exterminator.³⁵⁶ Relying on case law supporting California's concurrent causation analysis, they urged the court to rule that they were entitled to recover under the all risk policy because third-party negligence was not expressly excluded from coverage. The Texas Court of Appeals rejected the insureds' argument.³⁵⁷ It reversed the trial court judgment in favor of the insureds.

³⁴⁹ *Id.* at 469.

³⁵⁰ *Id.*

³⁵¹ *Id.* at 468.

³⁵² *Id.* at 470.

³⁵³ *Id.* at 469.

³⁵⁴ *Id.* at 468.

³⁵⁵ *Id.*

³⁵⁶ *Id.* at 470.

³⁵⁷ *Id.* at 470-71.

b. *The Mc Quade Case*

An exclusion for contamination losses was also enforced in an all risk homeowners policy in *Mc Quade v. Nationwide Mutual Fire Insurance Co.*³⁵⁸ The *Mc Quade* court found for the insurer on the ground that the contamination exclusion precluded any recovery.³⁵⁹ During the policy period, the insured hired an exterminator to rid his house of termites.³⁶⁰ The exterminator applied the chemical Chlordane in such liberal amounts that the house allegedly became uninhabitable for an extended period of time during which the insured temporarily resided elsewhere. The insured submitted a claim to recover under his homeowners policy. The property insurer denied coverage, citing the contamination exclusion.³⁶¹ The insured then sued the insurance company, alleging that it engaged in unfair and deceptive practices in relying on the contamination exclusion to deny coverage because the policy purported otherwise to give very broad coverage.

The policy at issue in *Mc Quade* provided that "We cover all risks of physical loss to the property described in Coverages A [Dwelling] and B except: . . . contamination."³⁶² The insured did not dispute that he sought to recover under the policy due to the Chlordane contamination of his home. The insurance company moved to dismiss the suit for failure to state a claim. In analyzing the language of the policy, the court found the policy to be unambiguous and ruled that the claim was barred by the express terms of the insuring agreement.³⁶³ Therefore, the court dismissed the insured's complaint.³⁶⁴

c. *The Hi-G Case*

In *Hi-G, Inc. v. St. Paul Fire & Marine Insurance Co.*,³⁶⁵ the court also enforced the contamination exclusion. The insured manufactured small electromechanical switching devices known as relays. The insured sued its property insurer to recover under a manufacturer's output insurance policy for a loss resulting from damage to the insured's products.³⁶⁶ As part of the insured's manufacturing

³⁵⁸ 587 F. Supp. 67 (D. Mass. 1984).

³⁵⁹ *Id.* at 68.

³⁶⁰ *Id.*

³⁶¹ *Id.*

³⁶² *Id.*

³⁶³ *Id.*

³⁶⁴ *Id.*

³⁶⁵ 283 F. Supp. 211 (D. Mass. 1967), *aff'd*, 391 F.2d 924 (1st Cir. 1968).

³⁶⁶ *Id.* at 211, 212.

process, relays were placed in a heated industrial oven with a vacuum environment. A brief power interruption occurred. When the electrical power resumed, an oil vapor permeated the oven and its contents. A nonremovable oil film coated the internal and external surfaces of the relays, destroying their usefulness and damaging the relays beyond repair.³⁶⁷ The insurer declined to pay because the policy contained the following exclusion: "PERILS EXCLUDED: This policy does not insure against . . . Loss or damage caused by or resulting from . . . contamination."³⁶⁸ The question before the district court was whether or not the damage to the relays constituted contamination within the meaning of the policy.³⁶⁹

The insured asserted that there could be no contamination of a product unless an actual physical change in the form or substance of the product took place. The trial court declined to restrict the contamination exclusion to such a degree.³⁷⁰ The First Circuit Court of Appeals affirmed, holding that it was not significant to the application of the contamination exclusion that a detectable physical change in the appearance of the property occurred.³⁷¹ The court held that contamination occurs within the meaning of the exclusion if a foreign substance injures a product's usefulness, even without affecting the product's original physical characteristics.³⁷²

d. The Myrick Case

An early case enforcing the contamination exclusion is *American Casualty Co. v. Myrick*.³⁷³ There was no coverage when the insured's poultry products were damaged after ammonia escaped from a metal pipe.³⁷⁴ The insured was in the business of processing and distributing poultry and eggs. A large refrigerated storage room used by the insured was cooled by an ammonia coolant flowing through a system of overhead coils. Goods belonging to the insured became

³⁶⁷ 391 F.2d at 925.

³⁶⁸ 283 F. Supp. at 212.

³⁶⁹ *Id.*

³⁷⁰ *Id.* at 212-13.

³⁷¹ 391 F.2d at 925. The court of appeals reasoned: "We cannot see how anyone could reasonably think that whether the contaminant entered into a chemical reaction with the spoiled goods was in any way significant [to the coverage issue]." *Id.*

³⁷² *Id.*

³⁷³ 304 F.2d 179 (5th Cir. 1962).

³⁷⁴ *Id.* at 181, 184.

unfit for human consumption when the overhead coils fell to the floor, allowing gaseous ammonia to saturate the storage room.³⁷⁵

The insured submitted a claim to recover for the value of the lost goods under two insurance policies. One policy insured against "direct loss resulting from . . . explosion."³⁷⁶ The second policy insured all risks of "direct physical loss or damage to the insured property from an external cause."³⁷⁷ The latter policy contained an exclusion for "contamination . . . unless caused by or resulting from loss of or damage to the property covered by . . . explosion."³⁷⁸

The insured asserted that there was coverage because the ammonia escaped with sufficient violence to constitute an explosion.³⁷⁹ Alternatively, the insured contended that the loss was proximately caused not by contamination but by the covered external cause of exposure to ammonia gas.³⁸⁰ The jury returned a verdict in favor of the insured.

On appeal, the Fifth Circuit Court of Appeals discussed at length the meaning of the word "explosion,"³⁸¹ and concluded that the evidence was insufficient to find that an explosion had occurred.³⁸² The court then rejected the insured's argument that exposure to ammonia gas constituted a covered external cause apart from the contamination that proximately caused the loss.³⁸³ In light of testimony by a chemist that the damage was caused by a chemical reaction between ammonia and the water in the poultry goods, the court concluded that the loss was due to contamination.³⁸⁴ In reversing the trial court judgment, the court of appeals held that "[t]o say that there was an external cause which was the proximate cause of the loss does not eliminate the exclusion from the contract. Since the

³⁷⁵ *Id.* at 181.

³⁷⁶ *Id.* at 182.

³⁷⁷ *Id.* at 181.

³⁷⁸ *Id.*

³⁷⁹ *Id.* at 181-82.

³⁸⁰ *Id.* at 182.

³⁸¹ *Id.* at 182-83.

³⁸² *Id.* at 183. *But see* American Alliance Ins. Co. v. Keleket X-Ray Corp., 248 F.2d 920, 923 (6th Cir. 1957) (affirming a jury verdict that the escape of radium salt from a capsule was of sufficient magnitude to comprise an explosion).

³⁸³ 304 F.2d at 184.

³⁸⁴ *Id.* at 183-84; *see also* American Produce & Vegetable Co. v. Phoenix Assur. Co. of N.Y., 408 S.W.2d 954, 956 (Tex. Civ. App. 1966) (coverage was barred under a policy containing a contamination exclusion, where it was undisputed that damage to the insured's food in storage was caused by leaking ammonia).

evidence establishes that the appellee's goods were contaminated, the exclusion in the policy must be given effect."³⁸⁵

3. Revised Contamination Exclusion

A recent ISO endorsement titled "Changes—Pollutants"³⁸⁶ is intended to address contamination claims in commercial policies.³⁸⁷ It replaces the former contamination exclusion.³⁸⁸ The express wording of the endorsement makes no reference to contamination or contaminants, but refers to "pollutants," a term defined in the endorsements.³⁸⁹

The endorsement, by its express terms, is intended to apply to all losses where covered property becomes contaminated as the proximate result of an insured peril.³⁹⁰ The endorsement alters the Commercial Property Cause of Loss—Special Form³⁹¹ by providing that there is no coverage unless a release, discharge, or dispersal of pollutants is caused by one of the specified causes of loss.³⁹² When there is an ensuing loss by one of the specified causes of loss,³⁹³ there is an exception to the new contamination exclusion, and coverage will exist solely for the damage resulting from any one or more of the specified causes of loss. This provision continues the exception of coverage, found in earlier all risk policies, for losses due to non-

³⁸⁵ 304 F.2d at 184.

³⁸⁶ CP 01 86 04 86.

³⁸⁷ Ozog & Ponzi, *supra* note 155, at 179.

³⁸⁸ MALLIN, *supra* note 4, at 109.

³⁸⁹ See *supra* note 174 and accompanying text.

³⁹⁰ MALLIN, *supra* note 4, at 109.

³⁹¹ CP 10 30 11 85.

³⁹² CP 01 86 04 86. Section C of the endorsement modifies Special Form CP 10 30 11 85 in the following manner:

C. The CAUSES OF LOSS—SPECIAL FORM is revised as follows:

1. The exclusion of "Release, discharge or dispersal of contaminants or pollutants" in paragraph B.2.d.(4) is deleted.

2. The following Exclusion is added:

We will not pay for loss or damage caused by or resulting from the release, discharge or dispersal of "pollutants" unless the release, discharge or dispersal is itself caused by any of the "specified causes of loss." But if loss or damage by the "specified causes of loss" results, we will pay for the resulting damage caused by the "specified cause of loss."

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³⁹³ The definition section (§ F) of the Causes of Loss—Special Form CP 10 30 11 85 defines "Specified Causes of Loss," in pertinent part, to mean: "Fire; lightning; explosion; windstorm or hail; smoke; aircraft or vehicles; riot or civil commotion; vandalism; leakage from fire extinguishing equipment; sinkhole collapse; volcanic action; falling objects; weight of snow, ice or sleet; water damage." *Id.* Copyright, Insurance Services Office, Inc., 1986.

excluded perils that happen as a result of an excluded risk. Although the new endorsement does not expressly refer to coverage for "ensuing losses," case law interpreting that phrase in earlier policy forms may presage how some courts will interpret and apply the new endorsement.³⁹⁴

Under this endorsement, if a fire results from the release of a pollutant, there should be no coverage for damage to covered property due solely to contamination. Coverage should exist, however, for damage caused by the resulting fire. No reported cases have yet interpreted the above provision of the endorsement. It is anticipated, however, that the endorsement will be a significant improvement in clarifying the scope of property insurance coverage over earlier standard contamination exclusions. It should reduce the possibility that coverage will be found for contamination claims where none was intended.³⁹⁵

V. DEFENSES BASED ON POLICY PERIOD, CONTRACTUAL LIMITATION PERIOD, AND UNTIMELY NOTICE OF CLAIM

Quite apart from the mandatory elements of a loss that must be satisfied for coverage or the exclusions that may preclude coverage

³⁹⁴ In *Roberts v. State Farm Fire & Casualty Co.*, 146 Ariz. 284, 705 P.2d 1335 (1985), the court found the standard ensuing loss clause to be unambiguous. The phrase was not defined in the policy. The court relied, however, upon a dictionary definition to find "ensuing" to mean "to take place afterward . . . to follow as a chance, likely or necessary consequence: RESULT . . . to follow in chronological succession." *Id.* at 286, 705 P.2d at 1337 (quoting WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 756 (1969)). The policy excluded coverage for loss caused by insects. A swarm of bees built a hive in an inaccessible location in the insured's attic. After the bees were exterminated, honey from the vacant hive began to leak into the insured's dining room, causing damage. The insureds sought to recover the cost of repairing the damage to the dining room as an ensuing loss, but conceded that the actual damage caused by the bees themselves—the cost of tearing out the hive and the accompanying repairs—was not covered. The court applied a plain-meaning reading and ruled that "the loss, due to honey seepage, is an ensuing loss and is covered by the policy, unless one of the other various exclusions applies." *Id.* (emphasis in original); see also *Lambros v. Standard Fire Ins. Co.*, 530 S.W.2d 138, 141–43 (Tex. Civ. App. 1975) (where underground water damage was the cause rather than the consequence of the settling of the dwelling foundations, a policy covering ensuing loss caused by water damage and excluding loss caused by the settling of foundations did not provide coverage); *Goldner v. Otsego Mut. Fire Ins. Co.*, 39 A.D.2d 440, 443, 336 N.Y.S.2d 717, 720 (1972) (finding the phrase ambiguous and ruling that if the covered peril of explosion proximately caused the excluded peril of water to enter the structure and cause damage, such water damage constituted an ensuing loss); *Aetna Ins. Co. v. Getchell Steel Treating Co.*, 395 F.2d 12, 15–17 (8th Cir. 1968) (a control panel fire occurring contemporaneously with an electrical disturbance was covered as an ensuing fire under an unambiguous policy clause excluding coverage for losses resulting from an electrical disturbance to electrical appliances unless fire ensued).

³⁹⁵ See generally MALLIN, *supra* note 4, at 109.

for certain risks, there may be no coverage because the claim occurred outside of the period of time the policy was in effect. Also, in instances where the insured elects to file suit to seek a recovery on the policy, the insured's court action may be time-barred by the contractual limitations provision in the relevant policy. In some instances, moreover, the claim may not be covered because the insured has failed to give timely notice of the contamination loss to the insurance company.

A. Policy Period Defense

Property insurance policies are intended to afford protection only for covered losses that occur during the period of coverage designated in the declarations.³⁹⁶ The policy period defense may succeed where the insurer can establish that the contamination loss took place either before the policy became effective or after it terminated.³⁹⁷ Unlike fire losses, where the date of loss is usually obvious, different legal questions arise where there is an interval of time between the act giving rise to contamination and the occurrence of the actual damage.³⁹⁸ Contamination losses may fall under the category of continuing property damage that takes place during overlapping policy periods with successive insurers.

A recent decision by the California Court of Appeal should provide renewed credibility to the policy period defense in continuing-damage claims. The case addressed coverage for a continuing-damage claim for property damage that first manifested itself before one of the insured's policies was issued. In *Home Insurance Co. v. Landmark Insurance Co.*,³⁹⁹ the court declined to apportion responsibility

³⁹⁶ See, e.g., *Cambron v. North-West Ins. Co.*, 70 Or. App. 51, 54, 687 P.2d 1132, 1134 (1984) (there was no coverage under a homeowners policy that specified that the "policy period" expired at 12:01 a.m. on the date of the fire for damage to the insured's property that took place at 3:00 a.m. on the morning the policy expired).

³⁹⁷ See, e.g., *St. Michael's Orthodox Catholic Church v. Preferred Risk Mut. Ins. Co.*, 146 Ill. App. 3d 107, 110-11, 496 N.E.2d 1176, 1178-79 (1986) (a church could not recover for damage caused by the leakage of its roof where the leaking started nine months before the policy went into effect and the insured failed to establish the extent of damage that took place after the policy was issued); *Southern Cal. Edison Co. v. Harbor Ins. Co.*, 83 Cal. App. 3d 747, 760, 148 Cal. Rptr. 106, 113 (1978) (insured not entitled to reimbursement of expenses under property insurance for "mudjacking operations" to minimize damage from faulty foundations because the cause and damage by differential settlement had occurred and were apparent prior to the date the property policy took effect).

³⁹⁸ See generally Hook, *Respective Liability of First Party Policies Where Loss is Continuous Throughout Several Policy Periods*, in *The All Risk Policy: Its Problems, Perils and Practical Application*, 1986 ABA SEC. TORT AND INS. PRAC. 257.

³⁹⁹ 253 Cal. Rptr. 277 (Ct. App. 1988).

for the loss between successive property insurers where the damage was apparent before the second policy took effect.⁴⁰⁰ The two insurers had issued successive policies covering a hotel during a period of continuing property damage due to concrete spalling (cracking and chipping).⁴⁰¹ The court ruled that the insurer covering the risk at the time of the first visible manifestation of damage⁴⁰² was responsible for the entire loss.⁴⁰³ The second insurer had no responsibility for indemnifying the insured for the damage.⁴⁰⁴

In reaching its decision, the court rejected the first insurer's argument that coverage for the loss should have been apportioned between the insurers, based on the exposure theory commonly used in asbestos cases in California.⁴⁰⁵ In rejecting the arguments for

⁴⁰⁰ *Id.* at 281.

⁴⁰¹ *Id.* at 278-79. The case was decided on cross-motions for summary judgment based upon an agreed statement of facts. *Id.* at 279. The insurers stipulated that the insured's hotel contained structural defects that first became visible in December, 1980 in the form of concrete spalling. *Id.* One insurer issued a policy that covered the hotel from October, 1980 through October, 1981. *Id.* at 278. The second insurer issued coverage on the hotel through the date the claim was made in 1983. *Id.* Spalling of the concrete exterior of the hotel became progressively worse from the time of its first manifestations until the damage was repaired in December, 1983. *Id.* at 279. The California Court of Appeal held that the trial court correctly ruled that the insurer on the risk at the time of the first visible manifestation of damage was responsible for the entire loss. The appellate court, therefore, affirmed the trial court's judgment granting summary judgment in favor of the second insurer. *Id.* at 278.

⁴⁰² The court used the term "manifestation" to mean "when the damage first 'bec[ame] apparent.'" *Id.* at 280 (quoting *California Union Ins. Co. v. Landmark Ins. Co.*, 145 Cal. App. 3d 462, 476, 193 Cal. Rptr. 461, 469 (1983)). The court limited its analysis to the stipulated facts before it, under which the date of manifestation and discovery of the property damage were the same. *Id.* The court declined to consider the question of whether the date of manifestation might differ from the date of discovery in some cases. *Id.*

⁴⁰³ *Id.* at 280-81.

⁴⁰⁴ *Id.* at 281. The court held:

[A]s between two first-party insurers, one of which is on the risk [*i.e.*, covered the risk of loss] on the date of the first manifestation of property damage, and the other on the risk after the date of the first manifestation of property damage, the first insurer must pay the entire claim. We wish to stress that our holding is limited to the stipulated facts before us.

Id.

⁴⁰⁵ *Id.* at 281-82. Under the exposure theory relied on in California for asbestos bodily injury cases, an insurer is liable during any policy period in which there is exposure to an injury-causing agent. *Id.* at 281. The court declined to apply a recent California case that employed such reasoning in construing liability coverage for a third-party claim against an insured arising from continuing property damage. *Id.* (discussing *California Union Ins. Co. v. Landmark Ins. Co.*, 145 Cal. App. 3d 462, 193 Cal. Rptr. 461 (1983)). Based upon *California Union*, in an effort to recover for continuing earth movement damages or pollution losses occurring over time, many insureds have filed claims against a series of successive insurers. Utilizing such an approach, insureds have often succeeded in obtaining a settlement from each of the successive carriers. See generally Hook, *Multiple Policy Period Losses and Liability Under First-Party Policies*, 21 TORT & INS. L.J. 393, 397-401 (1985) (discussing apportion-

apportionment,⁴⁰⁶ the court distinguished between property damage claims and asbestos bodily injury claims.⁴⁰⁷ The court reasoned that a ruling to the contrary would have violated the rule that only fortuitous losses are insurable.⁴⁰⁸ Even though additional property damage occurred during the period when the second insurer covered the risk, the court refused to find the second insurer liable in any amount for the continuing damage that first materialized before its policy was issued. The court was persuaded that a different result would foster uncertainty within the insurance industry about the nature and extent of risks that were covered. It reasoned that such uncertainty would ultimately increase the cost of insurance for consumers and provide a disincentive to insureds to purchase adequate coverage.

An important issue not addressed in *Home v. Landmark* was the question of when damage was sufficiently manifested to establish the liability of the successive insurers. The court tacitly applied a "reasonable person" standard of discovery,⁴⁰⁹ but specifically left open the question of the correct standard to apply.⁴¹⁰ The court also left open the question of whether successive property insurers could be liable on the loss before the damage was discovered.⁴¹¹

ment of damages among successive insurance carriers). The *Home v. Landmark* decision should effectively put an end to that practice. See Katofsky, *Subsiding Away: Can California Homeowners Recover From Their Insurer For Subsidence Damages to Their Homes?* 20 PAC. L.J. 783, 800-01 (1989) (contrasting the outcome for coverage among successive insurers under *California Union* with the result directed by *Home v. Landmark*).

⁴⁰⁶ In concluding that the trial court properly declined to follow the exposure theory embraced in *California Union*, the court criticized that decision and noted that the decision "misapplied three pre-manifestation cases to hold a post-manifestation carrier jointly and severally liable." *Home v. Landmark*, 253 Cal. Rptr. at 282. The *Home v. Landmark* court also observed that the holding in *California Union* had been limited to the specific circumstances of that case by the same appellate court that decided it. *Id.* at 281 (citing Harbor Ins. Co. v. Central Nat'l Ins. Co., 165 Cal. App. 3d 1029, 1038, 211 Cal. Rptr. 902, 908 (1985)).

⁴⁰⁷ The *Home v. Landmark* court explained that the exposure theory is inapplicable in the context of first-party property damage claims. 253 Cal. Rptr. at 281; accord Hook, *supra* note 405, at 398-99 (discussing the difficulties in applying standard rules of first-party policy interpretation to claims involving progressive loss or damage).

⁴⁰⁸ The court relied upon the "loss in progress" rule. *Home v. Landmark*, 253 Cal. Rptr. at 281-82 & n.4 (citing Southern Cal. Edison Co. v. Harper Ins. Co., 83 Cal. App. 3d 747, 148 Cal. Rptr. 106 (1978)).

⁴⁰⁹ *Id.* at 282-83. The first insurer argued that the trial court erred in inferring that the deterioration in the concrete exterior was severe enough in December, 1980 to put a reasonable person on notice of a loss. The court rejected that argument. *Id.* at 282-83. The court indicated that it would rule that a property loss should be covered by the insurer that insured the risk during the period it first became "reasonably observable by the insured" if it had the opportunity to do so. See *id.* at 279-80.

⁴¹⁰ *Id.* at 282 n.5.

⁴¹¹ *Id.* at 279-80.

The unanswered questions in *Home v. Landmark* have now been addressed in subsequent decisions by the California Court of Appeal in determining the timeliness of an insured's lawsuit against a property insurer. In *Prudential-LMI v. Superior Court*,⁴¹² the court expressly adopted a "reasonable person" standard, and held that the "inception of the loss" for evaluating the insured's duty to make a claim began to run when the loss became "reasonably observable."⁴¹³ In cases involving progressive property damage unknown to the insured, the court implicitly recognized that undiscovered property damage may trigger coverage.⁴¹⁴

The Washington Supreme Court enforced the policy period defense in a latent defect case in *Villella v. Public Employees Mutual Insurance Co.*⁴¹⁵ The court ruled that coverage was triggered only after compensable damage took place.⁴¹⁶ There was no covered loss during the effective period of one of the insured's two policies. The insured argued, however, that the alleged negligent installation of a drainage system around his house set in motion a continuous process of soil destabilization that resulted in differential settlement of the foundation.⁴¹⁷ Because the alleged negligence and destabilization of the soil occurred during the period that the first policy was in effect, the insured asserted that coverage existed for damage to his residence that subsequently manifested itself.⁴¹⁸ The insurer defended by pointing out that the first policy lapsed in August, 1982, and that the insured's own experts confirmed that the residence was not damaged until November, 1983.⁴¹⁹

The court in *Villella* did not reach the issue of apportioning indemnity for continuing damage among successive property insur-

⁴¹² 260 Cal. Rptr. 85 (Ct. App. 1989) (the *Prudential-LMI* case is of interest for discussion purposes only because, pending review by the California Supreme Court, the decision by the Court of Appeal has no precedential value and may not be cited as authority), *review granted*, Sept. 21, 1989; *see also* *Fire Ins. Exch. v. Superior Court*, 212 Cal. App. 3d 339, 260 Cal. Rptr. 299 (1989).

⁴¹³ 260 Cal. Rptr. at 86. The court held that both the insured's duty to make a claim under a property policy and the policy's one-year suit limitation provision are triggered when the damage becomes sufficient to put a reasonable person on notice of the defect in the insured's property. *Id.* at 86, 98.

⁴¹⁴ *Id.* at 99. *See* INS. LIT. REP., Sept. 1989, at 374, 375-76. While not a necessary part of its decision, the court implied that the prior insurers could be liable instead of or in addition to the insurer on the risk at the time that the damage first became manifest.

⁴¹⁵ 106 Wash. 2d 806, 725 P.2d 957 (1986).

⁴¹⁶ *Id.* at 814, 725 P.2d at 961.

⁴¹⁷ *Id.* at 810-11, 725 P.2d at 959-60.

⁴¹⁸ *Id.* at 811, 725 P.2d at 960.

⁴¹⁹ *Id.* at 810-11, 725 P.2d at 959-60.

ers.⁴²⁰ Distinguishing the authority that construed liability policies on which the insured relied,⁴²¹ the court concluded that there had been no continuing process of *damage* to the insured's residence during the effective period of the first policy.⁴²² Although the alleged latent defect in the drainage system and the soil destabilization occurred during the policy period, the insured could not recover under the first policy because there was no compensable damage during that policy period.⁴²³

There are no reported decisions enforcing the policy period defense in the context of a contamination claim.⁴²⁴ Cases addressing such a defense in other contexts, however, illustrate that whether the defense succeeds will probably depend on when actual damage became

⁴²⁰ See *id.* at 811–14, 725 P.2d at 960–61.

⁴²¹ The insured relied primarily on the earlier Washington case of *Gruol Construction Co. v. Insurance Co. of North America*, 11 Wash. App. 632, 633, 637, 524 P.2d 427, 429, 431 (1974), which held that where property damage was a continuous process involving an undiscovered, progressively worsening condition of dry rot that was set in motion at the time of construction, all three liability insurers of the contractor at different times were jointly and severally liable. See *Villella*, 106 Wash. 2d at 811, 725 P.2d at 960. The *Villella* court distinguished *Gruol*, noting that in *Gruol* the damage to the building was initiated at the time of construction and continued throughout the time that each of the three insurers provided liability coverage. *Id.* Unlike the situation before the *Villella* court, in *Gruol* the insured structure itself was damaged during each policy period. See *id.* at 811–12, 725 P.2d at 960. The *Villella* court was also persuaded by other Washington authority that construed the continuous coverage rule of *Gruol* as requiring that a covered injury occur during the effective period of the contested policy. See *id.* at 812, 725 P.2d at 960 (citing *Castle & Cook, Inc. v. Great Am. Ins. Co.*, 42 Wash. App. 508, 517, 711 P.2d 1108, 1113 (1986)). The *Villella* court noted that, under *Gruol* and similar California cases, the insurer “‘on the risk’ when the negligent act was committed *and the initial damage suffered*, was responsible for . . . the damages that accrued after its policy expired.” *Id.* (emphasis in original) (citing *California Union Ins. Co. v. Landmark Ins. Co.*, 145 Cal. App. 3d 462, 211 Cal. Rptr. 902 (1985)). Because there was no covered injury during the first policy period, the *Villella* court did not decide the apportionment question. See *id.* at 814, 725 P.2d at 961.

⁴²² *Villella*, 106 Wash. 2d at 811–12, 725 P.2d at 960.

⁴²³ *Id.* at 814, 725 P.2d at 961.

⁴²⁴ In *Blaine Richards & Co. v. Marine Indemnity Insurance Co. of America*, 635 F.2d 1051 (2d Cir. 1980), however, the insurer defended a claim for losses due to Phostoxin-contaminated beans by alleging that the damages did not arise during the period of coverage of the policies. *Id.* at 1053. The district court did not consider this defense, but granted summary judgment in favor of the insurer based on exclusions in the policies. *Id.* On appeal, the Second Circuit Court of Appeals, while reversing in part and affirming in part, noted the defense, but did not address it on the merits. See *id.* at 1056. A related defense was addressed, however, in *Advanced Micro Devices v. Great American Surplus Lines Insurance Co.*, 199 Cal. App. 3d 791, 245 Cal. Rptr. 44 (1988). In this case, there was no coverage for the insured's costs incurred in removing a toxic contaminant from the premises of its semiconductor fabrication plant. *Id.* at 802, 245 Cal. Rptr. at 50. Such damage had already occurred prior to the inception of the policy and fell within the policy exclusions for pre-existing conditions known to the insured at the time the coverage went into effect. *Id.*

discernible, rather than when the latent contamination began.⁴²⁵ In *Western Fire Insurance Co. v. First Presbyterian Church*,⁴²⁶ a direct physical loss to property was caused by the accumulation of gasoline in the land around and underneath a church.⁴²⁷ The court did not agree with the insurance company's defense that the loss occurred *before* the policy went into effect.⁴²⁸ The pertinent insurance policy became effective on March 16, 1963.⁴²⁹ Several persons had previously noticed a strange odor in the basement of the church.⁴³⁰ The odor problem was considered to have been solved in February, 1963, when a leak in a natural gas line was discovered and repaired.⁴³¹ On March 28, 1963, the fire department issued an order closing the church as a health hazard due to the infiltration of gasoline into the soil under and around the church.⁴³²

The insurance company argued that the infiltration of gasoline onto the premises took place before the inception date of the policy.⁴³³ The Colorado Supreme Court affirmed the trial court's judgment in favor of the insureds, ruling that the direct physical loss was sustained by the church within the policy period.⁴³⁴ The court held that the direct physical loss occurred when the gasoline accumulated around the church to the extent that the building was rendered uninhabitable.⁴³⁵

B. Contractual Limitation and Untimely Notice of Claim Defenses

Apart from the policy period defense for claims in which the date of first manifestation so directs, the insurer should consider whether the contractual period for bringing suit has expired.⁴³⁶ A clause in

⁴²⁵ In *McConnell Construction Co. v. Insurance Co. of St. Louis*, 428 S.W.2d 659 (Tex. 1968), the insurer alleged that the Builders Risk Policy had expired before physical damage occurred. *Id.* at 662. The policy expired upon occupancy by the owner. *Id.* at 660. The Texas Supreme Court rejected the defense because the jury did not find that corrosion to the internal metal surfaces occurred *only after* the house was occupied by the new owner. *Id.* at 662.

⁴²⁶ 165 Colo. 34, 437 P.2d 52 (1968).

⁴²⁷ *Id.* at 38-39, 437 P.2d at 55.

⁴²⁸ *Id.* at 39, 437 P.2d at 55.

⁴²⁹ *Id.* at 36, 437 P.2d at 53-54.

⁴³⁰ *Id.*

⁴³¹ *Id.*

⁴³² *Id.* at 39-40, 437 P.2d at 55.

⁴³³ *Id.*

⁴³⁴ *Id.* at 40, 437 P.2d at 55-56.

⁴³⁵ *Id.* at 39, 437 P.2d at 55.

⁴³⁶ Examples of suit limitation provisions in standard property policies are: Commercial Line MP 00 90 (Ed. 07 00) (conditions applicable to Section I), which provides: "No suit shall be

an insurance policy limiting the time within which suit may be initiated on the policy is valid and enforceable absent a statute to the contrary.⁴³⁷ An action to recover policy proceeds is usually barred, when reasonable under the circumstances, if it is brought after the expiration of the contractual time limit.⁴³⁸

No decisions exist that apply the suit limitation defense in a contamination context.⁴³⁹ An insurer, however, should not overlook the

brought on this policy unless the insured has . . . commenced the suit within one year after the loss occurs," and Homeowner Form HO-3 (Ed. 04 84) (Sec. I-Conditions), which provides: "No action can be brought . . . unless the action is started within one year after the date of loss."

⁴³⁷ See 18A COUCH ON INSURANCE 2D § 75:88 (1983 & Supp. 1989); 20A J. APPLEMAN, INSURANCE LAW AND PRACTICE § 11611 (1980 & Supp. 1989); Reader & Polk, *The One-Year Suit Limitation in Fire Insurance Policies: Challenges and Counterpunches*, 19 FORUM 24 (1983). Statutory treatment of such clauses among the states varies. Oregon has adopted a one-year contractual limitation provision as part of a statutory fire policy. OR. REV. STAT. § 743.660 (1987). New Hampshire has required the insurer to notify the insured of the deadline for bringing suit before the period expires. N.H. REV. STAT. ANN. § 407:15 (1983) (also mandating that the contractual limitation becomes effective only 12 months after the insured is notified of the clause by the insurance company). At least one state has enacted legislation declaring such provisions void. See MONT. CODE ANN. § 28-2-708 (1989) (restraint upon legal proceedings void); see also *Fremont Mut. Ins. Co. v. Michigan Basic Property Ins. Ass'n*, 171 Mich. App. 500, 502, 430 N.W.2d 764, 766 (1988) (suit for contribution filed by a fire insurer against a successive insurer was time-barred as a "suit or action on the policy" subject to the one-year contractual limitation period in a relevant policy).

⁴³⁸ See Reader & Polk, *supra* note 437, at 25. The authors discuss the extent to which suit limitation provisions are enforceable. The majority rule is that "inception of the loss" refers to the time the physical loss occurred. *Id.* at 34 & n.76. At least one court has ruled that the phrase means the date when a cause of action accrues. *Id.* at 35 & n.81. Courts sometimes avoid the impact of the suit limitation provision by finding that the running of the period has been tolled. *Id.* at 35-36. In some circumstances, courts will decline to enforce the provision by finding that compliance has been excused or that the insurer is precluded by waiver or estoppel from asserting the defense. *Id.* at 37-47.

Two recent California Court of Appeal decisions have enforced the contractual limitation defense to bar coverage and found that the period for bringing suit began to run when the property damage at issue became reasonably observable. See *Prudential-LMI Commercial Ins. Co. v. Superior Court*, 260 Cal. Rptr. 85, 86 (Ct. App. 1989) (pending review by the California Supreme Court, the decision by the Court of Appeal has no precedential value and may not be cited as authority), *review granted*, Sept. 21, 1989; *Fire Ins. Exch. v. Superior Court*, 260 Cal. Rptr. 299, 304 (Ct. App. 1989). See generally Annotation, *Validity of Contractual Time Period, Shorter Than Statute of Limitations, For Bringing Action*, 6 A.L.R.3D 1197 (1966 & Supp. 1989); Annotation, *Property Insurance: Insured's Ignorance of Loss or Casualty, Cause of Damage, Coverage or Existence of Policy, or Identity of Insurer, as Affecting or Excusing Compliance with Requirements as to Time for Giving Notice, Making Proof of Loss, or Bringing Action Against Insurer*, 24 A.L.R.3D 1007 (1969 & Supp. 1989).

⁴³⁹ In *Blaine Richards & Co. v. Marine Indemnity Insurance Co. of America*, 635 F.2d 1051 (2d Cir. 1980), the insurer defended a claim for losses due to bean contamination by alleging that the suit was untimely. *Id.* at 1053. The district court did not rule on that defense and the court of appeals merely noted, but did not discuss, the defense. *Id.*; see also *United Technologies Corp. v. Liberty Mut. Ins. Co.*, No. 87-7172, slip op. (Mass. Super. Ct. Oct. 24,

limitation of suit defense where the time of loss can be isolated to a period outside the limitation. On a related point, if an insured delays in notifying an insurer of the loss, it may prejudice the insurer's ability to properly investigate the claim.⁴⁴⁰ In such instances, an insurer should consider whether an insured has violated the policy condition requiring prompt or immediate notice of loss.⁴⁴¹

We have analyzed many of the valid terms and conditions regularly included in standard property policies that limit coverage or that exclude risks from coverage so that there should be no insurance protection for contamination claims. Nevertheless, we also have reviewed potential reasons why an insured might allege that coverage for contamination losses should be provided. An insurer that denies a claim for pollution-related losses should do so only after making an in-depth investigation of the facts and a close review of the applicable insurance policy, as well as consulting with legal counsel.

1988), reported in PROPERTY LOSS RES. BUREAU L. REV., Nov. 1988, at 2966. The court dismissed the insured corporation's declaratory judgment action complaint against its property insurers because the insured failed to comply with the relevant policies' pre-suit requirements, that is, the insured gave no notice of the potential claims and conveyed no information regarding the damage or extent of the losses prior to filing suit. *Id.* at 2967. The property insurers had issued insurance policies covering 40 separate locations that were implicated in environmental claims for which the insured sought coverage. Each of the policies provided: "No suit or action on this policy for the recovery of any claim shall be sustainable in any court of law or equity unless all the requirements of this policy shall have been complied with." *Id.* (quoting slip op. at 3).

Because the insured had not satisfied its pre-suit policy obligations, the insurers had not carried out any investigations, adjustments, or appraisals relating to the insured's claim. The court was persuaded that, in the property insurance context, compliance with pre-suit policy conditions lessens the litigation burden on the judiciary by defining specific areas of disagreement between the insurer and the insured. *Id.* at 2967-68.

⁴⁴⁰ See, e.g., *Colonial Gas Energy Sys. v. Unigard Mut. Ins. Co.*, 441 F. Supp. 765 (N.D. Cal. 1977). Substantial prejudice was established as a matter of law when an insured, seeking to recover for physical loss or damage to a liquid natural gas storage tank, altered and resealed the tank before giving the insurer notice of the claim. By so doing, the insured made inaccessible the only source of evidence that could have established the insurer's sole defense. *Id.* at 769-71. But see *United Technologies*, No. 87-7172, slip op. (Mass. Super. Ct. Oct. 24, 1988) (property insurers were not required to show that they were prejudiced by the insured's failure to satisfy the pre-suit policy conditions).

⁴⁴¹ For a discussion of the general principles governing the requirement of timely notice of loss, see 13A COUCH ON INSURANCE 2D § 49:34 (1982 & Supp. 1989); 3 J. APPLEMAN, INSURANCE LAW AND PRACTICE § 1391 (1967 & Supp. 1989). Most jurisdictions require a showing of actual prejudice by delay in order to sustain a denial of coverage for lack of timely notice. See, e.g., *Prudential-LMI Commercial Ins. Co. v. Superior Court*, 260 Cal. Rptr. 85, 99 (Ct. App. 1989) ("[M]ere delay or lateness of notice does not result in a presumption of prejudice to the insurer, who bears the burden to show it suffered actual prejudice, in the form of inability to conduct an adequate investigation or otherwise defend the claim."), review granted, Sept. 21, 1989.

VI. PUBLIC POLICY CONSIDERATIONS BEARING ON THE AVAILABILITY OF PROPERTY INSURANCE COVERAGE FOR POLLUTION LOSSES

In addition to the policy terms and conditions explored above, there are compelling public policy considerations that favor enforcing limitations on coverage to deny insurance protection for cleaning up environmental pollution. At the crux of the issue is the question of who should bear the costs of polluting our environment.⁴⁴² The answer to that question can be found in the public policy expressed by the United States Congress in enacting the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA).⁴⁴³

Congress established CERCLA's unique liability provisions in order to require those who "profited or otherwise benefited from commerce involving [hazardous] substances" to pay the costs of cleaning up hazardous wastes.⁴⁴⁴ Congress intended that those who derived financial benefits from activities resulting in pollution should be required to internalize the health and environmental costs of such activities into their costs of doing business.⁴⁴⁵

⁴⁴² This question was recently addressed by the Washington Supreme Court in *Boeing v. Aetna Casualty & Surety Co.*, No. 55700-4, slip op. at 6 n.1 (Wash. Jan. 4, 1990) (en banc). The court held that the term "damages" in a pre-1986 CGL policy included response costs to investigate and remedy actual releases of hazardous wastes. In a spirited dissent, two justices of that court argued that the holding of the majority violated the public policy expressed by the United States Congress in CERCLA that polluters, not their insurers, should pay to clean up environmental pollution. *Id.* at 21-29 (Callow, C.J., dissenting).

⁴⁴³ Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), 42 U.S.C. §§ 9607-9657 (1982).

⁴⁴⁴ *Boeing*, No. 55700-4, slip op. at 21 (Callow, C.J., dissenting) (citing S. REP. NO. 848, 96th Cong., 2d Sess. 98, reprinted in SENATE COMM. ON ENV'T. & PUB. WORKS, LEGISLATIVE HISTORY OF THE COMPREHENSIVE ENVIRONMENTAL RESPONSE, COMPENSATION, AND LIABILITY ACT OF 1980, PUBLIC LAW 96-510, Vol. 1 at 308, 405, 97th Cong., 2d Sess. (1983) (statement of EPA Administrator Costle)). See, e.g., *United States v. Northeastern Pharm. & Chem. Co.*, 579 F. Supp. 823, 841 (W.D. Mo. 1984) (Congress intended to impose Superfund liability for the effects of past disposal practices "as a means to spread the costs of the cleanup on those who created and profited from the waste").

⁴⁴⁵ *Boeing*, No. 55700-4, slip op. at 22 (Callow, C.J., dissenting) (citing S. REP. NO. 848 at n.2). See *Developments in the Law—Toxic Waste Litigation*, 99 HARV. L. REV. 1458, 1477 (1986) (explaining that Congress intended to promote "corrective justice" by making responsible parties liable for cleaning up hazardous waste releases under the federal hazardous waste statutory scheme presently in place); see also *City of Philadelphia v. Stepan Chem. Co.*, 544 F. Supp. 1135, 1142-43 (E.D. Pa. 1982) (noting that the one key objective of CERCLA is to promote cleaning up the environment and placing the ultimate financial burden on those responsible for the hazardous wastes); *United States v. Reilly Tar & Chem. Corp.*, 546 F. Supp. 1100, 1112 (D. Minn. 1982) ("Congress intended that those responsible for problems caused by the disposal of chemical poisons bear the costs and responsibility for remedying the

Congress did not intend that insurers should bear the expense of cleaning up environmental pollution.⁴⁴⁶ Insurers, under either property or liability policies, should not be called upon to indemnify polluters—such as waste generators, transporters, toxic chemical users, or dumpsite owners or operators—for environmental losses. A finding of insurance coverage for such claims will permit the polluters to enjoy the maximum benefits of their polluting activity while spreading the financial burden of their actions to non-polluting insureds.⁴⁴⁷ The net effect of allowing insurance coverage for pollution claims is to cause non-polluting policy holders to subsidize the activities of polluters. The recognition of insurance coverage for pollution risks, therefore, may operate to defeat the congressional intent that those responsible for pollution should pay to clean it up.⁴⁴⁸

Providing insurance protection for contamination risks actually may promote greater risk-taking by insureds and result in increased environmental pollution.⁴⁴⁹ If some courts impose coverage for pol-

harmful conditions they created.”). The congressional intent can be summed up in the slogan, “Make the polluter pay.” See *Boeing*, No. 55700-4, slip op. at 22 (Callow, C.J., dissenting); *Developments*, *supra* note 5, at 1477.

⁴⁴⁶ See Letter from Douglas M. Costle, EPA Administrator, to Hon. Jennings Randolph (Sept. 25, 1979), reprinted in SENATE COMM. ON ENV'T & PUB. WORKS, LEGISLATIVE HISTORY OF THE COMPREHENSIVE ENVIRONMENTAL RESPONSE, COMPENSATION, AND LIABILITY ACT OF 1980, PUBLIC LAW 96-510, Vol. 1, 97th Cong., 2d Sess. (1983); see also Brett, *Insuring Against and Innovative Liabilities and Remedies Created by Superfund*, 6 J. ENVTL. L. 1, 52 (1986) (“[I]t is contrary to public policy to allow a responsible party to pass on the costs of cleanup, as well as other costs recoverable under Superfund, to its insurance carrier, and thereby retain the benefit of having another perform its public duty without ever having paid for it.”).

⁴⁴⁷ Some courts have cited an emphasis on risk-spreading efficiency, that is, distributing the single loss of one insured among a large pool of insureds, to justify extending insurance coverage under the ambiguity doctrine. See Note, *Insurance as Contract: The Argument for Abandoning the Ambiguity Doctrine*, 88 COLUM. L. REV. 1849, 1856 (1988). That approach disrupts the efficiency of the insurance market, however, and causes all premium rates to rise. *Id.* at 1860-62.

⁴⁴⁸ *Boeing*, No. 55700-4, slip op. at 22 (Callow, C.J., dissenting). The dissent in *Boeing* inferred the following reasoning for the congressional intent that polluters should pay for cleaning up the environment:

Congress clearly recognized that corporate polluters have reaped enormous benefits from their past inadequate waste disposal practices. These practices created significant short-term savings for polluters, resulting in higher profits for them, but caused enormous long-term harm in the form of environmental degradation. CERCLA response cost liability forces these polluters to disgorge these profits.

Id.

⁴⁴⁹ See Fields, *Superfund: The Court Search for Insurance Money*, BRIEF, Fall 1984, at 7, 9. The author remarks that New York's insurance code at one time mandated the pollution exclusion. The prohibition on pollution liability insurance was intended by the Legislature to buttress New York's environmental protection standards. The New York Legislature was concerned that the state's environmental protection effort would be undermined if businesses

lution losses, insureds may then underallocate resources for contamination-related loss prevention efforts after purchasing insurance.⁴⁵⁰ The tendency of an insured to take less care to avoid losses than it otherwise would if it were not insured is referred to in insurance circles as the "moral hazard."⁴⁵¹ When an insured can "externalize" the costs of environmental losses by purchasing insurance, that insured's incentive to engage in loss prevention efforts will be reduced.⁴⁵²

An approach requiring polluters to pay for cleaning up the environment, rather than their insurers, has received the support of

could purchase insurance to protect themselves from liability for polluting the environment. *Id.* (citing N.Y. LEGIS. ANN. 1971, at 353-54; 19 N.Y. Laws 2633).

The legislative history of the statute explains:

For example, a polluting corporation might continue to pollute the environment if it could buy protection from potential liability for only the small cost of an annual insurance premium, whereas, it might stop polluting if it had to risk bearing itself the full penalty for violating the law.

Niagara County v. Utica Mut. Ins. Co., 80 A.D.2d 415, 418, 439 N.Y.S.2d 538, 540 (1981) (quoting N.Y. LEGIS. ANN. 1971, at 353-54). In *Niagara County*, the New York Court of Appeals stated that the pollution exclusion in liability insurance policies was intended to "buttress New York's strict environmental protection standards. These standards could be undermined if commercial enterprises were able to purchase insurance to protect themselves from liability arising from their pollution of the environment." *Id.* A thorough reading of the history of the New York legislation mandating the inclusion of a pollution exclusion in liability policies in that state, however, directs that the bar to liability coverage for pollution losses was intended to be broadly applied, that is, to non-commercial as well as commercial entities. See Note, *The Pollution Exclusion Through the Looking Glass*, 74 GEO. L.J. 1237, 1270-71 (1986).

⁴⁵⁰ See ABRAHAM, *DISTRIBUTING RISK: INSURANCE, LEGAL THEORY AND PUBLIC POLICY* 14-15 (1986).

⁴⁵¹ *Id.* at 14, 35; see also Epstein, *Products Liability as an Insurance Market*, 14 J. LEGAL STUD. 645, 653 (1985) ("Individuals with insurance against certain types of losses are more likely to engage in risky conduct.") (citing Shavell, *On Moral Hazard and Insurance*, 98 Q.J. ECON. 541 (1979)); Priest, *The Current Insurance Crises in Modern Tort Law*, 96 YALE L.J. 1521, 1547 (1987) (defining "*ex ante* moral hazard" as "the reduction in precautions taken by the insured to prevent the loss, because of the existence of insurance").

⁴⁵² ABRAHAM, *supra* note 450, at 17. Abraham notes: "If a[n insured] firm's actual expected loss is high, but insurance premiums are only crudely rated, it may be economically irrational for the firm to conduct its activities more safely. It may be better off free riding on the loss prevention efforts of other members of its risk class." *Id.*; see also MEHR & CAMMACK, *supra* note 6, at 13, 14 (positing that insurance coverage "is also responsible in some cases for losses induced by carelessness because insurance may eliminate one's incentive to protect property or control losses once they occur"). Where coverage is priced below the insured's experience costs for prevention, insureds may not take safety precautions that would otherwise be worthwhile. In such circumstances, insureds may be able to obtain equivalent protection against risk by purchasing insurance at a lesser cost than the expenses for the precautions. ABRAHAM, *supra* note 450, at 78. Abraham also states that "inaccurate pricing or classification can allow insureds to externalize the risk of liability and to ignore the benefits of loss prevention efforts." *Id.* at 44.

environmentalists because of its strong anti-pollution incentives.⁴⁵³ By declining to recognize either property or liability insurance coverage for pollution losses, heightened incentives will be imposed on those responsible for environmental contamination and they will be motivated to take extra precautions to protect the environment.⁴⁵⁴ The corresponding improvements in the manufacturing processes used by industrial concerns, the safer disposal of hazardous waste by those involved in such activity, and the enhanced care exercised by all who handle or use potential pollutants should ultimately lead to a cleaner and healthier environment.⁴⁵⁵

Environmental risks do not fit smoothly within the framework of losses that can be insured against. An insurer's most important method of mitigating the so-called "moral hazard," and thereby encouraging effective cost-internalization by insureds, is to create risk classifications and to vary the premium prices charged for coverage depending on the anticipated loss experience of each class of insureds.⁴⁵⁶ The deterrent effect of insurance is dependent on how accurately the premiums can be set and the risks classified. These principles, however, cannot be applied readily to risks of loss due to contamination.⁴⁵⁷

Property and liability insurers cannot calculate and assess insurance premiums that bear any meaningful relationship to environ-

⁴⁵³ Wall Street Journal, Aug. 1, 1989, at B1, col. 2 (requiring polluters rather than their insurers to pay for the cost of cleaning up their pollution is "supported by environmentalists because of its inherent anti-pollution incentives" and because it "provides strong incentives against future pollution and holds past polluters accountable").

⁴⁵⁴ See Note, *supra* note 449, at 1253 (since the early 1970's, insurers have urged the view that industrial concerns will improve their manufacturing and disposal processes if insurance coverage is absent for pollution losses due to the exclusion contained in standard liability policies).

⁴⁵⁵ See *id.* at 1253 n.82.

⁴⁵⁶ ABRAHAM, *supra* note 450, at 15, 48.

⁴⁵⁷ *Id.* at 46-47. In discussing the deterrent effect of liability insurance coverage for toxic torts, Abraham notes the highly speculative nature of predicting such liability and explains that:

For many reasons, the amount of damage that current and past uses of toxic substances ultimately will cause cannot be predicted. Scientific uncertainty is one reason; knowledge of the hazardous properties of toxic chemicals is in its infancy. [footnote omitted] The synergistic effect of chemicals that have been mixed together during storage in waste dumps are even less clear. The ways in which hazardous waste migrates from storage facilities into contiguous property and water supplies are not completely predictable. And toxic tort disasters tend to be catastrophic in scope and sporadic in occurrence. All this makes it very difficult to predict the ultimate riskiness of activities involving toxic substances.

Id. at 47.

mental risks.⁴⁵⁸ In the past, insurers have not calculated or charged insureds an accurately-priced insurance premium sufficient to pay for environmental clean-up coverage.⁴⁵⁹ Given the absence of realistic data about the presence and nature of potential contaminants in our environment, it will not be possible for insurers accurately to classify insureds according to their probability of experiencing pollution losses or the magnitude of such losses if they occur.⁴⁶⁰ Because there is presently no way for insurers to accurately predict which subclassifications of insureds may experience environmental losses, environmental risks are fundamentally uninsurable as a practical matter.⁴⁶¹

Despite Congress's stated policy that polluters should pay to clean up the environment, and notwithstanding the unsuitability of insur-

⁴⁵⁸ *Boeing v. Aetna Cas. & Sur. Co.*, No. 55700-4, slip op. at 23 (Wash. Jan. 4, 1990) (Callow, C.J., dissenting). The dissent explained that, in the context of liability policies,

An insurer who undertakes to insure response cost liability [under CERCLA] will therefore be liable for risks that are undiscovered and largely undiscoverable at the time the actions [that ultimately create the liability] are taken. "Because the magnitude of such risks is inestimable—they're unknowable when insured against—it is impossible confidently to set a price for insurance against them."

Id. at 26 (Callow, C.J., dissenting) (quoting Abraham, *Environmental Liability and the Limits of Insurance*, 88 COLUM. L. REV. 942, 958 (1988)). The *Boeing* dissent concluded that an insured's potential liability for response costs under CERCLA cannot be assessed by insurers seeking to set premium levels. *Id.* at 28 (Callow, C.J., dissenting) (citing U.S. DEPT OF TREASURY, ADEQUACY OF PRIVATE INSURANCE PROTECTION UNDER SECTION 107 OF THE COMPREHENSIVE ENVIRONMENTAL RESPONSE, COMPENSATION, AND LIABILITY ACT OF 1980: A REPORT IN COMPLIANCE WITH SECTION 301(B) OF P.L. 96-105, at 83-87, 94-95 (June 1983)).

⁴⁵⁹ *Id.* at 22 (Callow, C.J., dissenting); see also Note, *CERCLA Cleanup Costs Under Comprehensive General Liability Insurance Policies: Property Damage or Economic Damage?*, 56 FORDHAM L. REV. 1169, 1176 (1988) (when issuing older liability policies, insurers did not anticipate or plan for paying the costs of cleaning up the environment).

⁴⁶⁰ *Boeing*, No. 55700-4, slip op. at 23 (Callow, C.J., dissenting). The dissent stated that: "[R]esponse costs [are] particularly difficult to insure . . . [because of] CERCLA's imposition of liability for harms the party did not cause." *Id.* at 26; see also Abraham, *supra* note 458, at 959-60. Abraham commented that liability under CERCLA

[C]reates special uncertainty, because the probability of liability—and of consequent loss for the insurer—is affected by the behavior of non-policyholders whom the insurer cannot necessarily identify in advance. When the scope of that liability is potentially very large, that uncertainty is magnified.

....

In order to insure against this threat, insurers would have to make nearly impossible calculations based on both the potential behavior of the other parties whose activities might combine with the insured's to cause damage, and on the probability that these parties would prove to be judgment proof.

Id.

⁴⁶¹ *Boeing*, No. 55700-4, slip op. at 23 (Callow, C.J., dissenting). The dissent concluded that CERCLA liability is "fundamentally uninsurable" and noted that the novel components of CERCLA's liability scheme make it impossible for insurers to charge premiums bearing any genuine relationship to the risks involved. *Id.*

ance coverage for environmental losses, some courts have created insurance coverage for contamination claims when the express language of the relevant policy should not provide it.⁴⁶² When these courts invent coverage for environmental losses, contrary to insurance policy terms, they do so to the ultimate detriment of insureds.⁴⁶³ In expanding coverage beyond the express terms and conditions of insurance policies, these courts most notably have relied upon the related doctrines of ambiguity of contract⁴⁶⁴ and the reasonable expectations of the insured.⁴⁶⁵ Because polluters should pay the costs

⁴⁶² Abraham, *supra* note 458, at 960 (noting with displeasure that "judicial interpretations of policy language that insurers had regarded as fixed, clear, and limiting have expanded the scope of coverage against both the old and new forms of environmental liability").

⁴⁶³ Since the enactment of CERCLA, pollution insurance has become unavailable in any insurance market. *Boeing*, No. 55700-4, slip op. at 28 (Callow, C.J., dissenting) (citing Smith, Weishaar, Ledbetter & Light, *Hurricane SARA: An Introduction to the 1986 Superfund Amendments*, 2 Toxics L. Rep. (BNA) 1104, 1110 (1987)); see also Abraham, *supra* note 458, at 944 ("[F]or most businesses in the United States insurance against environmental liability is completely unavailable."). Many corporate insureds link the unavailability of environmental insurance to judicial decisions expanding coverage beyond that provided by the contractual terms. Insurers may be simply unwilling to issue insurance designed to cover pollution losses because the coverage will probably not be limited by the terms of the contract. In formal communications to the EPA, according to Hewlett-Packard, the "absence of viable markets" for environmental insurance coverage is caused by a "fear of our present judicial system and their insistence that all losses are recoverable—when only asked to discover the appropriate 'deep pocket' and, in the absence of policy coverage, coverage will be created for you." Rulemaking Comment, Sept. 4, 1985, from Gerrold Keating, Risk Manager, Hewlett-Packard, to U.S.E.P.A. Revisions to 40 C.F.R. pts. 264, 265; see also Rulemaking Comment in the same proceeding from John Stallings, Senior Staff Environmental Engineer, Kerr-McGee Corporation at 2 (Sept. 18, 1985) ("[M]uch of the current insurance availability difficulty seems related to interpretations by some courts . . . [that] have broadened what is included under coverage far beyond what insurers would reasonably expect under . . . the conditions insurance was provided."); Note, *Insurance as Contract: The Argument for Abandoning the Ambiguity Doctrine*, 88 COLUM. L. REV. 1849, 1862 (1988) ("[B]y unpredictably extending policy coverage, courts render insurance companies unable to closely tailor premiums to particularized risks.").

⁴⁶⁴ The ambiguity doctrine is a rule of construction generally directing that any ambiguity in an insurance contract must be construed strictly against the insurance company. See 13 J. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 7401 (rev. ed. 1976); 2 COUCH ON INSURANCE 2D § 15:83 (1984). Other authors note that "there are literally thousands of judicial opinions resolving insurance coverage disputes in favor of claimants on the basis that a provision of the insurance policy at issue was ambiguous and therefore should be construed against the insurer." R. KEETON & A. WIDISS, *INSURANCE LAW: A GUIDE TO FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES AND COMMERCIAL PRACTICES* § 6.3(a)(2), at 629 (practitioner's ed. 1988). The ambiguity doctrine derived originally from the contract principle of *contra proferentem*. See RESTATEMENT OF CONTRACTS § 236(d) (1932) ("Where words or other manifestations of intention bear more than one reasonable meaning an interpretation is preferred which operates more strongly against the party from whom they proceed, unless their use by him is prescribed by law.").

⁴⁶⁵ The reasonable expectations doctrine has been most widely applied as an interpretative tool in the construction of ambiguities in insurance contracts. Note, *A Common Law Alternative to the Doctrine of Reasonable Expectations in the Construction of Insurance Contracts*,

of cleaning up environmental hazards directly, however, such doctrines should not compel a finding of insurance coverage for pollution losses.

A number of justifications have been advanced for construing insurance policies against an insurance company⁴⁶⁶ that should have no application to a business insured that is a polluter. An unqualified bias for an insured should be inappropriate in instances where an insurance policy is the product of "arm's-length bargaining."⁴⁶⁷ Yet, some courts continue to rule in favor of insureds based on perceived ambiguities in policies when the insured is a sophisticated business or even another insurance company.⁴⁶⁸ That outcome may result

57 N.Y.U.L. REV. 1175, 1185 (1988) [hereinafter Note, *A Common Law Alternative*]. Some courts have expanded the doctrine to apply to the entire transaction of purchasing insurance, rather than limiting it to the interpretation of specific terms of the contract. Anderson, *Reasonable Expectations and Insurance Contracts: What Should We Reasonably Expect From Judges?*, FOR THE DEF., Apr. 1986, at 9, 11; see also Note, *The Reconstruction of Insurance Contracts Under the Doctrine of Reasonable Expectations*, 18 J. MARSHALL L. REV. 155, 161 (1984) [hereinafter Note, *The Reconstruction*]. Under a broad application of the doctrine, the reasonable expectations of the insured determine the insurer's obligations, notwithstanding unambiguous policy provisions to the contrary. Note, *A Common Law Alternative*, *supra*, at 1186-87. An exhaustive discussion of the evolution and specific applications of the reasonable expectations doctrine is beyond the scope of this Article.

⁴⁶⁶ Under most circumstances, courts will act to protect insureds from contracts of adhesion—contracts that are drafted by a party of superior bargaining strength and offered to the weaker party on a take-it-or-leave-it basis. See S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 900, at 19-20 (3d ed. 1963). In the insurance context, the use of adhesion contracts has been cited by some courts to justify bias against insurers. See, e.g., *Hahn v. Alaska Title Guar. Co.*, 557 P.2d 143, 145 & n.5 (Alaska 1976) (noting that "[u]sually, as in this case, the insured is presented with a form policy and has no choice as to its provisions"). Some courts will construe coverage in the insured's favor because most insurance policies are drafted on standard forms. Some courts do not interpret form contracts under traditional contract principles because these courts presume that mutual assent to all of the contract provisions has not taken place. See, e.g., *Zuckerman v. Transamerica Ins. Co.*, 133 Ariz. 139, 144-45, 650 P.2d 441, 446-47 (1982) ("The only aspect of the contract over which the insured can 'bargain' is the monetary amount of coverage."); *Travelers Indem. Co. v. Armstrong*, 384 N.E.2d 607, 613 (Ind. Ct. App. 1979) ("An insurance contract is prepared and drafted solely by the insurance company subject to no real bargaining and, thus, is a contract of adhesion."), *aff'd as modified on other grounds*, 442 N.E.2d 349, 366 (Ind. 1982). For a survey of "modern rationales for the judicial bias against insurers," see Note, *supra* note 22, at 1854-57. The author identifies the following reasons cited by some courts as a basis for construing policies against insurance companies: (1) protecting individuals from adhesion; (2) the standard form nature of insurance policies; (3) detrimental reliance by insureds believing that they have purchased sufficient coverage; (4) the quasi-public nature of the insurance industry; (5) the efficacy of spreading the risk of a single loss among a pool of insureds; (6) simple "paternalism towards the insured"; and (7) traditional principles of equity.

⁴⁶⁷ Insurance contracts for business insureds are often the product of arm's length bargaining. See Note, *Insurance as Contract: The Argument for Abandoning the Ambiguity Doctrine*, 88 COLUM. L. REV. 1849, 1857 (1988).

⁴⁶⁸ See, e.g., *ACandS, Inc. v. Aetna Cas. & Sur. Co.*, 764 F.2d 968, 973 (3d Cir. 1985)

though the bargaining power of some business insureds may exceed that of the insurance company offering the policy.⁴⁶⁹

A judicial orientation by some courts unilaterally favoring insured commercial polluters also overlooks that there is often fierce competition among insurance companies to acquire business entities as insureds.⁴⁷⁰ Benefitting from the competition to issue commercial coverage, corporate insureds enjoy the option of choosing among policy forms and terms, have policies specifically written for them, and comparison shop for the lowest available insurance premiums.⁴⁷¹ Under such circumstances, the notion that business insureds must be protected from overreaching by "monopolistic and abusive" insurers does not withstand scrutiny.⁴⁷²

(applying Pennsylvania law and strictly construing the language of the liability insurance policy against the insurance company even though the insured was a large commercial entity that bargained with the insurer); *H.K.H. Co. v. American Mortgage Ins. Co.*, 685 F.2d 315, 319 (9th Cir. 1982) (applying Nevada law and observing that under Nevada law any ambiguity in an insurance contract is construed against the insurer, even when the insured is a commercial party); *Commercial Standard Ins. Co. v. General Trucking Co.*, 423 So. 2d 168, 171 (Ala. 1982) (rejecting the argument that the ambiguity rule should be ignored in a dispute between two insurance carriers); Abraham, *supra* note 458, at 960 ("[Expansive] judicial interpretations of policy language that insurers had regarded as fixed, clear, and limiting have expanded the scope of coverage" even "where the policyholder was a business entity with access to counsel.").

⁴⁶⁹ Note, *supra* note 467, at 1857-58. In highlighting the bargaining power of some corporate insureds, the author observes that it is not unusual for large companies to hire "corporate risk managers" and to employ risk management staff to review company insurance needs and negotiate and purchase insurance coverage. The author notes that, in some instances, an insured's bargaining power may actually exceed that of the insurer. Under such facts, an unqualified bias for the insured is inappropriate. *Id.*

⁴⁷⁰ See *id.* at 1859.

⁴⁷¹ See *id.*; Anderson, *supra* note 24, at 14 (characterizing today's insurance market as intensely competitive among insurers "all to the benefit of policyholders").

⁴⁷² Some courts have recognized an exception to the ambiguity rule in the commercial context. See, e.g., *MGIC Indem. Corp. v. Central Bank of Monroe*, 838 F.2d 1382, 1387 (5th Cir. 1988) (applying Louisiana law and enforcing a liability provision requiring the insured to give notice of a claim against it, without requiring the insurer to demonstrate prejudice, in part because the insured was a sophisticated business presumably conversant with the terms of its insurance contract); *Eastern Associated Coal Corp. v. Aetna Cas. & Sur. Co.*, 632 F.2d 1068, 1075 (3d Cir. 1980) (applying Pennsylvania law and stating that the rule "that ambiguities in policies should be strictly construed against the insurer does not control the situation where large corporations, advised by counsel and having equal bargaining power, are the parties to a negotiated policy"), *cert. denied*, 451 U.S. 986 (1981); *Travelers Indem. Co. v. United States*, 543 F.2d 71, 74-75 (9th Cir. 1976) (applying Oregon law and stating that "the rule [of strict construction against insurance companies] has no applicability when the language is supplied by the insured, his agent or his broker"); *American Home Products Corp. v. Liberty Mut. Ins. Co.*, 565 F. Supp. 1485, 1511 (S.D.N.Y. 1983) ("[R]elying on social policy to justify imputing an expectation of complete coverage to an insured" is unsupportable under New York law where the insured's expectations were consistent with the policy language and the contract at issue was a manuscript policy written specifically for the insured, a large manu-

A reliance by some courts on perceived contractual ambiguities to favor consumer insureds unilaterally works against the efficient use of standard form policies.⁴⁷³ Standard form policies are indispensable instruments of the insurance industry that render risk distribution feasible and economical.⁴⁷⁴ Their use should be continued although it is essentially an impossible task for insurers to redraft the language of standard form policies to eliminate every potential ambiguity.⁴⁷⁵

In the final analysis, intervention by some courts on behalf of even individual consumer insureds does not always operate as a principled decisional mechanism.⁴⁷⁶ Because all language conceivably can be characterized as ambiguous, sometimes courts are left with virtually unbridled discretion.⁴⁷⁷ Such broad discretion may be used by some courts to reach result-oriented decisions and to find coverage for pollution claims where otherwise there should be none. The interventionist approach is improper because it permits judges on those courts to reach an essentially legislative decision—that a mechanical bias against insurers is justified.⁴⁷⁸ This view, when applied uni-

facturer of goods), *aff'd as modified on other grounds*, 748 F.2d 760, 766 (2d Cir. 1984); J. Ray McDermott & Co. v. Fidelity & Cas. Co., 466 F. Supp. 353, 361 (E.D. La. 1979) ("[W]here the contract of insurance is prepared by the insured and its broker, and only presented to the underwriter for its acceptance, the reasons behind the rule of construction favoring the insured completely disappear."). Commentators have similarly argued against the application of the ambiguity rule in favor of a sophisticated insured. See Ostrager & Ichel, *The Role of Bargaining Power Evidenced in the Construction of the Business Insurance Policy: An Update*, 18 FORUM 577 (1983). The authors surveyed selected case decisions and identified the following indicia of the insured's equal or greater bargaining power vis-a-vis the insurer that some courts have relied upon in declining to apply a "contra-insurer" rule of policy construction: (1) the insured was represented by an independent insurance broker or agent in the negotiation and drafting of the policy; (2) the insured was a large company sophisticated in insurance practices; and (3) the insured extensively participated in the placement and administration of the policy. See also Note, *supra* note 18, at 1185 ("When dealing with a sophisticated insured, the public policy rationale for construing the document against the insurer disappears.").

⁴⁷³ A factor often overlooked by critics of standard form insurance contracts is that the use of form contracts economically benefits both the insurers and consumers by allowing insurance services to be provided more cheaply. See Note, *The Reconstruction*, *supra* note 465, at 170 n.91. The author characterizes standardized contracts as an "economic necessity" and summarizes some of these benefits. *Id.*

⁴⁷⁴ See Note, *supra* note 467, at 1861.

⁴⁷⁵ *Id.* at 1861-62; see also Abraham, *supra* note 458, at 961 ("[T]here is no completely reliable way for insurers to draft around the threat of judge-made insurance, because by definition this is coverage that ignores the apparent meaning of the policy language itself.").

⁴⁷⁶ See Note, *supra* note 22, at 1862.

⁴⁷⁷ *Id.* See, e.g., American Home Products Corp. v. Liberty Mut. Ins. Co., 565 F. Supp. 1485, 1512 (S.D.N.Y. 1983), *aff'd as modified on other grounds*, 748 F.2d 760, 766 (2d Cir. 1984). Absent adherence to the plain meaning of policy language, problems inherent to judicial exercise of an essentially legislative function are created. 565 F. Supp. at 1512.

⁴⁷⁸ Note, *supra* note 467, at 1864; see also Note, *supra* note 18, at 1178 ("Congress, with

formly, erroneously assumes that employing an anti-insurer bias ultimately benefits all insureds, which it does not.⁴⁷⁹

A penchant by some courts for finding coverage in contravention of the express language of the insurance policy should have no place in resolving questions of coverage for contamination claims. The judicial doctrines of ambiguity of contract⁴⁸⁰ and the reasonable expectations of the insured⁴⁸¹ have recently come under sharp criticism. In light of the public policy objective that the parties who pollute the environment should be responsible for cleaning it up, and considering that pollution claims do not constitute a risk that is readily insurable, the contra-insurer rule of construction must be superseded by a policy that seeks to hold polluters, not their insurers, liable for the remediation of pollution. Insurers are entitled to hold their insureds to the language of the policies purchased, and should not be required to cover pollution losses unless they have agreed in advance to do so and have received from the insured an appropriate insurance premium reflecting the uncertainties of the risk.

VII. ACCELERATED SUBROGATION THROUGH THIRD-PARTY PRACTICE

No matter how compelling the arguments may be against imposing liability on property insurers for contamination losses, when an insurer advances a legitimate basis to disclaim coverage, litigation by an insured against the insurance company may follow. In pollution

its superior fact-finding resources, occupies a much better position than the judiciary to formulate productive solutions to the problem" of cleaning up pollution).

⁴⁷⁹ See Note, *supra* note 467, at 1860 (arguing that a judicial bias against insurance companies interferes with the efficiency of the insurance market and raises the premium rates of all insureds).

⁴⁸⁰ For a discussion of the ambiguity doctrine and its flaws, see Note, *supra* note 467. The author argues that the ambiguity doctrine is an unprincipled and inefficient means by which to construe insurance contracts, and recommends that traditional contract law principles prevail in the matter of insurance construction. See *id.* at 1872.

⁴⁸¹ For a criticism of the doctrine of reasonable expectations, see Note, *The Reconstruction*, *supra* note 465 (concluding that the reasonable expectations doctrine is an unnecessary and unmanageable tool in the construction of insurance contracts). See *id.* at 175-76; Anderson, *supra* note 24, at 13-14 (criticizing the doctrine of reasonable expectations and articulating a series of rhetorical questions examining the tendency of the courts to assume a legislative function when interpreting insurance contracts). One author has noted that a growing number of courts are retreating from the doctrine of reasonable expectations by narrowing its application. Rahdert, *Reasonable Expectations Reconsidered*, 18 CONN. L. REV. 323, 324 (1986); see also, e.g., *Casey v. Highlands Ins. Co.*, 600 P.2d 1387, 1391 (Idaho 1979) (applying contract law principles instead of the doctrine of reasonable expectations in order to avoid "the danger that the court might create liability when none was otherwise provided by construction of the contract terms or creation of a new contract for the parties") (emphasis added).

claims under property policies, it will often be the case that a third party is legally responsible for an insured's loss.⁴⁸² In that event, if the insured also has not sued the party who apparently caused the contamination in the same suit, the insurer should give serious thought to filing a third-party action against the party potentially responsible for the loss.

Upon payment of an insured's claim when a third party may be liable, a property insurer⁴⁸³ is entitled to recover the amount of the insurance payment through a subrogation⁴⁸⁴ claim against the responsible party.⁴⁸⁵ Under traditional subrogation princi-

⁴⁸² See, e.g., *Auten v. Employers Nat'l Ins. Co.*, 722 S.W.2d 468 (Tex. Ct. App. 1986), *writ denied*, 749 S.W.2d 497 (Tex. 1988). A professional exterminator misapplied pesticides and rendered the insureds' home uninhabitable. The insureds sued both the exterminator and their homeowners insurer. In the suit for policy proceeds, the jury found that the exterminator was negligent, that the misapplication of pesticides caused a physical loss to the insureds' home, and that the loss was not caused by contamination. *Id.* Accordingly, the trial court ruled that the insurer was liable under the policy. The trial court allowed the insurer to offset its damages, however, and awarded the insureds only their attorney fees because they had already settled with the exterminator. *Id.* On review, the Texas Court of Appeals reversed the trial court's ruling and held as a matter of law that the insureds' loss was caused by contamination, for which there was no coverage under the policy. *Id.* at 471.

⁴⁸³ Principles of subrogation usually come into play in the recovery of payments made by insurers under property insurance policies. The application of subrogation to payments under liability policies is much less frequent. MEHR & CAMMACK, *supra* note 6, at 134; RODDA, *supra* note 7, at 8.

⁴⁸⁴ Subrogation may arise through principles of equity and may also be provided under the express terms of an insurance contract. MEHR & CAMMACK, *supra* note 6, at 132; RODDA, *supra* note 7, at 8. Subrogation has been defined as the "substitution of one creditor for another, the new creditor succeeding to the former's rights." THOMAS & REED, *supra* note 9, at 127; see also BLACK'S LAW DICTIONARY 1279 (5th ed. 1979) ("Insurance companies . . . generally have the right to step into the shoes of the party whom they compensate and sue any party who the compensated party could have sued."); BALLENTINE'S LAW DICTIONARY 1229-30 (3d ed. 1969) ("The principle of subrogation is broad enough to cover every instance in which one person is required to pay a debt for which another is primarily answerable, and which in equity and good conscience ought to be discharged by the latter."); MAGEE & SERBEIN, *supra* note 190, at 91 ("Subrogation, as it applies in the field of insurance, is the substituting of the insurer who paid the loss for the claimant so that, if there is any responsibility on the party primarily liable for the loss, the insurer may reimburse itself.").

⁴⁸⁵ From a public policy standpoint, it is reasonable to allow the insurer to collect from the wrongdoer under the right of subrogation because otherwise: (1) the insured could collect twice—from its insurer and against a third-party tortfeasor for the same loss; and (2) the responsible party might escape liability altogether, even though it was responsible for the loss. MEHR & CAMMACK, *supra* note 6, at 131-32; RODDA, *supra* note 7, at 8; THOMAS & REED, *supra* note 9, at 127; MAGEE & SERBEIN, *supra* note 190, at 91.

In instances where the insured's loss is not sufficiently covered by the policy and the insurer pays the policy limits, the insurer may pursue subrogation for the full amount of its payment. In many jurisdictions, however, the insured is entitled to first-dollar recovery of any proceeds of the subrogation claim by the insurer. The insured must be made whole before any subrogation recovery can be realized by the insurer. MEHR & CAMMACK, *supra* note 6, at 133.

Under such circumstances, it is not uncommon for an insurer and an insured to enter into

ples,⁴⁸⁶ however, an insurer is not entitled to pursue a subrogation action to recover amounts that it may in the future be compelled to pay, but has not yet paid,⁴⁸⁷ as indemnification to an insured.⁴⁸⁸

a loan receipt agreement that authorizes the insurer to pursue the insured's uncovered loss as well as the amount paid under the insurance policy. The insured and the insurer ordinarily agree to bear a proportionate share of the litigation expenses and attorney fees in relation to the percentage each party's loss bears to the total recovery. The insured usually agrees that the insurer may control the litigation and may prosecute the claim in the insured's name alone. Under such an arrangement, the insurance payment is treated as a loan to the insured to be repaid to the insurer in the event of a sufficient recovery. See generally COUCH ON INSURANCE 2d §§ 61:185, 61:84, 74:423-74:429 (1983 & Supp. 1989). See also HUEBNER, BLACK & CLINE, *supra* note 5, at 69-70; THOMAS & REED, *supra* note 9, at 130.

⁴⁸⁶ Under a common-law right of subrogation, the insured is not required to take any affirmative action to support the insurer's subrogation lawsuit. The insurer merely has the right to file suit and substitute itself for the insured as plaintiff. One of the advantages of the standard subrogation clause in an insurance policy is that the insured is contractually obligated to cooperate with the insurer in subrogation proceedings. RODDA, *supra* note 7, at 8-9; MP 00 90 para. 6(a) (Ed. 07 77). The standard subrogation clause assigns to the insurer only those rights of action held by the insured. MEHR & CAMMACK, *supra* note 6, at 133.

The insurance company is relieved of any obligation to indemnify the insured under the policy and the insurer is entitled to recover from the insured any payment it has made, in the event the insured waives its right of recovery from another party *after* the loss has taken place. RODDA, *supra* note 7, at 9; THOMAS & REED, *supra* note 9, at 127-28; MP 00 90 para. 6(b) (Ed. 07 77). Prior to a loss, pursuant to the subrogation clause, the insured may have released from liability the party against whom a subrogation recovery might otherwise have been sought. In many such cases, however, the insured will not have jeopardized its right of recovery under the policy. Under the "waiver of subrogation" clause in the standard property insurance policy, the insurer voluntarily waives its subrogation rights where the insured has waived such rights in writing prior to the loss, for example, in the case of a lease of property to a tenant or for property belonging to others while on the premises of the insured. THOMAS & REED, *supra* note 9, at 127; MAGEE & SERBEIN, *supra* note 190, at 92; MP 00 90 para. 6(b)(1) (Ed 07 77).

⁴⁸⁷ A typical subrogation clause in a commercial property policy provides:

6. Subrogation.

(a) In the event of any payment under this policy, the Company shall be subrogated to all the insured's rights of recovery against any person or organization and the insured shall execute and deliver instruments and papers and do whatever else is necessary to secure such rights. The insured shall do nothing after loss to prejudice such rights.

(b) The Company shall not be bound to pay any loss if the insured has impaired any right of recovery for loss; however, it is agreed that the insured may:

(1) as respects property while on the premises of the insured, release others in writing from liability for loss prior to loss, and such release shall not affect the right of the insured to recover hereunder, and

(2) as respects property in transit, accept such bills of lading, receipts or contracts of transportation as are ordinarily issued by carriers containing a limitation as to the value of such goods or merchandise.

MP 00 90 (Ed. 07 77) (special multi-peril policy conditions and definitions).

⁴⁸⁸ COUCH ON INSURANCE 2D § 61:39 (1983 & Supp. 1989); see also MEHR & CAMMACK, *supra* note 6, at 132 ("[T]he claim must first be paid before the insurer can exercise the subrogation right.").

A property insurer considering its response to a contamination claim may be faced with a "Hobson's choice"—an election without an alternative.⁴⁸⁹ In the event an insurer determines that there is a valid basis to disclaim coverage for an insured's contamination claim, it will not be uncommon for the insured to disagree and threaten litigation unless the claim is paid. If an insurer pays a claim for which the policy provided no coverage, however, the insurer is merely a volunteer payee that has no right of subrogation.⁴⁹⁰ On the other hand, if an insurer denies the claim and an insured ultimately prevails in its lawsuit for coverage, the insurer's potential subrogation action may be jeopardized because of an inability to preserve vital evidence or the expiration of an applicable limitations period.⁴⁹¹

In practice, one solution to this dilemma used by insurers is resort to third-party actions in claims disputes where an insured has sued an insurance company.⁴⁹² In the context of environmental claims, an insurer's decision to pursue a subrogated claim against a third party who is responsible for the loss embodies the public policy objectives expressed by Congress that those responsible for pollution damage should pay for cleaning it up. A third-party action by an insurer also should function as a deterrent against future pollution activity by the responsible tortfeasor.⁴⁹³

⁴⁸⁹ *Pictorial Review Co. v. Helvering*, 68 F.2d 766, 769 (D.C. Cir. 1934) (defining a "Hobson's choice" as an election by compulsion or without freedom of choice). *See, e.g., Louisville and Jefferson County Metro. Sewer Dist. v. Travelers Ins. Co.*, 753 F.2d 533, 538-40 (6th Cir. 1985). The insured was a municipality that operated a wastewater treatment plant that was damaged when a third party illegally dumped toxic waste into the sewer system. *Id.* at 534. After the property insurer denied coverage for the loss, the insured sued both its property insurer and the potentially liable tortfeasors. *Id.* at 535. Before the suit against the insurer was resolved, the insured recovered 97.7% of its losses (totalling \$299,669) from the manufacturer and handlers of the toxic material. Although the court reduced the insurer's liability under the policy accordingly (leaving \$6,892 of the loss outstanding), it ordered the insurer to pay its proportionate share of the insured's litigation expenses incurred in the suit against the responsible third parties (the insurer's share totalled \$104,628). *Id.*

⁴⁹⁰ *THOMAS & REED*, *supra* note 9, at 127.

⁴⁹¹ *Krause v. American Guar. & Liability Ins. Co.*, 22 N.Y.2d 147, 239 N.E.2d 175 (1968) (noting the "extreme injustice" to the insurers if they were required to resolve the main claim by the insured before initiating a claim against the third-party tortfeasor). *But see Consolidated Edison Co. v. Royal Indem. Co.*, 41 A.D.2d 37, 40, 340 N.Y.S.2d 991, 995 (1973) (dissent argued vigorously that the insurer should be required to pay the insured's claim prior to initiating a third-party action against the party responsible for the loss).

⁴⁹² *See, e.g., Consolidated Edison*, 41 A.D.2d at 40, 340 N.Y.S.2d at 994 (the appellate court affirmed the trial court's decision to deny the third-party defendant's motion to dismiss the third-party complaint where otherwise the potential subrogation claim might have become time-barred).

⁴⁹³ *ABRAHAM*, *supra* note 450, at 51-57 (by exercising subrogation rights, a subrogated compensation fund may play a potentially significant role in deterring risky activities giving rise to toxic tort liability by third parties).

Some courts have allowed insurers to initiate "accelerated" subrogation actions against tortfeasors responsible for an insured's property damage *before* finally resolving and making payment on an insured's claim.⁴⁹⁴ This practice has been allowed under federal⁴⁹⁵ and state⁴⁹⁶ civil procedure statutes permitting a defendant to implead a third party "who is or may be liable" to the defendant for the damages sought in the plaintiff's original suit.⁴⁹⁷ Under such an approach, insurers, as defendants in suits brought by their insureds, are permitted to expedite subrogation by impleading a negligent third party ultimately responsible for an insured's loss.

⁴⁹⁴ See, e.g., *J&B Schoenfeld v. Albany Ins. Co.*, 109 A.D.2d 370, 374, 492 N.Y.S.2d 38, 41-42 (1985) (the insurer's act of impleading the alleged tortfeasor as a third-party defendant is the extent of the subrogation right that an insurer may exercise prior to making a payment to the insured on a claim).

⁴⁹⁵ Federal courts construing Federal Rule of Civil Procedure 14(a), governing third-party actions, have regularly permitted insurance companies to implead third-party defendants based on a contingent subrogation theory. See, e.g., *Concordia College Corp. v. Great Am. Ins. Co.*, 14 F.R.D. 403, 405 (D. Minn. 1953) (permitting an insurer to implead an architect and subcontractor on theories of negligence and breach of warranty on an inchoate claim for subrogation under the terms of an insurance policy). *Glens Falls Indem. Co. v. Atlantic Bldg. Corp.*, 199 F.2d 60, 63 (4th Cir. 1952) (reversing the district court's dismissal of the defendant insurer's third-party complaint, stating that: "Rule 14 was designed to prevent this circuity of action and to enable the rights of an indemnitee against an indemnitor and the rights of the latter against a wrongdoer to be finally settled in one and the same suit"); *St. Paul Fire & Marine Ins. Co. v. United States Lines Co.*, 258 F.2d 374, 375-76 (2d Cir. 1958) (held that the insured's filing of the third-party complaint had tolled the running of the pertinent statute of limitations, even though the subrogation rights on which the complaint was based would not accrue until some time later, after the insured had paid the underlying judgment), *cert. denied*, 359 U.S. 910 (1959); *International Harvester Co. v. General Ins. Co. of Am.*, 45 F.R.D. 4, 8 (E.D. Wis. 1968) ("The fact that . . . [an insurer] has not as yet paid or may not have to pay the claim is immaterial" in an impleader action against a third party pursuant to Federal Rule of Civil Procedure 14(a)); *Monarch Indus. Corp. v. American Motorist Ins. Co.*, 276 F. Supp. 972, 980 (S.D.N.Y. 1967) (although the insurer was not authorized to bring a separate suit as a subrogee until the insured had been paid, the insurer could sue the third-party tortfeasor under Federal Rule of Civil Procedure 14(a)); *Lee's Inc. v. Transcontinental Underwriters*, 9 F.R.D. 470, 471 (D. Md. 1949) (the potential prejudice to the insureds did not outweigh the possible benefits to be derived from the use of third-party procedure to implead the potentially liable third party).

⁴⁹⁶ See e.g., *Cleveland-Cliffs Iron Co. v. First State Ins. Co.*, 105 Mich. App. 487, 307 N.W.2d 78 (1981) (insurer was entitled to implead third-party defendants based on their potential liability, despite the fact that insurer had not paid insured's claim); *Foley Mach. Co. v. Amland Contractors, Inc.*, 209 N.J. Super. 70, 77, 506 A.2d 1263, 1267 (1986) (citing New Jersey Civil Practice Rule 4:27-1(b) and relying on the court's policy of resolving all aspects of a controversy in a single action, the Appellate Division of the Superior Court ruled that an insurer had standing to assert a third-party claim as subrogee even though it had not yet paid its insured's claim).

⁴⁹⁷ In *Glens Falls*, the appellate court reversed the trial court, concluding that the impleader action could not have been dismissed in the exercise of the court's discretion, because to do so would "clearly frustrate the purpose" of the third-party practice rule. 199 F.2d 60, 64 (4th Cir. 1952).

A recent decision by the Illinois Appellate Court, however, has established a judicial precedent tending to discredit this short-cut route to subrogation. In *Johnson v. State Farm Insurance Co.*,⁴⁹⁸ the court ruled against the use of accelerated subrogation through third-party practice. The court held that third-party civil suits could not be utilized to circumvent the common-law rule requiring an insurer to pay its insured prior to pursuing any subrogation rights.⁴⁹⁹ Under the Illinois court's ruling, the standard subrogation clause in the property policy at issue precluded the insurer from impleading a third party into the underlying action initiated by the insureds.⁵⁰⁰ That was the outcome, even though the third party allegedly was responsible for the damage to the insured's property.⁵⁰¹

Under the Illinois statute governing third-party proceedings,⁵⁰² the defendant insurer was authorized, with court approval, to implead a non-party "who is or may be liable" for "all or part of the plaintiff's claim."⁵⁰³ The insurer argued that, in the interest of fairness, the third-party claim should have been allowed.⁵⁰⁴ The court disagreed, relying on the insureds' allegations of undue delay by the insurance company in settling their claim.⁵⁰⁵ In addition to the common-law subrogation doctrine that the debt must have been paid in full, the court also was persuaded by policy considerations favoring speedy payment to insureds.⁵⁰⁶

⁴⁹⁸ 151 Ill. App. 3d 672, 503 N.E.2d 602 (1987).

⁴⁹⁹ *Id.* at 673-74, 503 N.E.2d at 604. On appeal, the court affirmed the trial court's dismissal of the insurer's third-party complaint. *Id.* at 676, 503 N.E.2d at 605. The court rejected the insurer's contention that the trial court mistakenly relied on "anachronistic common law doctrines of subrogation" in requiring actual payment as a prerequisite to bringing a third-party action. *Id.* at 674, 503 N.E.2d at 604. Instead, the appellate court ruled that the express terms of the subrogation clause required the insurance company to pay its insureds before it could maintain a third-party suit against the alleged tortfeasor. *Id.*

⁵⁰⁰ *Id.*

⁵⁰¹ *Id.* at 673, 503 N.E.2d at 603.

⁵⁰² ILL. REV. STAT., ch. 110, ¶ 2-406 (1985).

⁵⁰³ *Id.*

⁵⁰⁴ 151 Ill. App. 3d at 673-74, 503 N.E.2d at 604.

⁵⁰⁵ *Id.* at 673, 674, 503 N.E.2d at 603, 604.

⁵⁰⁶ *Id.* at 675, 503 N.E.2d at 605. The court explained:

[W]ere we to permit the insurer to proceed without having discharged its obligation to its insured, we would be defeating one of the primary functions of insurance—that is, recovering for one's losses quickly and simply by filing a claim with the insurer and avoiding the trouble, time, expense and uncertainty of lawsuits—while doing nothing to discourage the insurer from delaying the settlement of claims, such as has been alleged in the main complaint in this case.

Id. But see *Cleveland-Cliffs Iron Co. v. First State Ins. Co.*, 105 Mich. App. 487, 490, 307 N.W.2d 78, 82 (1981) (discussing the factors to be taken into account by the trial court in ruling on an insurer's attempt to use third-party practice to expedite subrogation).

New York courts have reached the opposite result from the Illinois decision. In *Cassel Vacation Homes, Inc. v. Commercial Union Insurance*,⁵⁰⁷ the Appellate Division of the New York Supreme Court reversed the trial court and ruled that the insurer's impleader action against an allegedly negligent third party was proper.⁵⁰⁸ The court ruled that the New York statute authorizing a third-party claim against any person "who is or may be liable" for all or part of the underlying claim permitted contingent claims based on subrogation.⁵⁰⁹ The court disagreed with the third-party defendant's position that the applicable insurance policies provided for a subrogation action only *after* the insurers actually paid the insured's claims.⁵¹⁰ The New York Court of Appeals articulated valid public policy reasons for allowing an accelerated subrogation action through the use of third-party practice in *Krause v. American Guaranty & Liability Insurance Co.*⁵¹¹

An immediate subrogation claim via third-party practice should be considered by insurers, where appropriate, to protect their contingent subrogation rights in pollution claims. By doing so, an insurer should be able to preserve important evidence of the third party's liability, and can avoid the risk that a later subrogation action may be time-barred. The recent Illinois appellate decision in *Johnson v. State Farm*, however, may undermine this approach. Nevertheless, the great weight of reported authority addressing the issue and the express wording of civil practice statutes in most jurisdictions support the use of impleader actions as a basis to accelerate subrogation.

An insurer confronted with an insurance action by its insured to collect for contamination damage to property caused by a negligent third party should not overlook this option. Insurers and their legal counsel should consult the third-party practice rules of the local jurisdiction and consider filing a claim against the responsible tortfeasor at the first opportunity.

VIII. CONCLUSION

The environmental crisis should not be resolved by saddling property insurers with responsibility for cleaning up and repairing pollution damage unless they have expressly agreed to provide such

⁵⁰⁷ 121 A.D.2d 674, 504 N.Y.S.2d 443 (1986).

⁵⁰⁸ *Id.* at 675, 503 N.Y.S.2d at 443.

⁵⁰⁹ *Id.* at 676, 503 N.E.2d at 444.

⁵¹⁰ *Id.*

⁵¹¹ 22 N.Y.2d 147, 155-56, 239 N.E.2d 175, 179-80 (1968).

coverage and have been fairly compensated for assuming such risks. This Article has surveyed many available defenses that should exclude coverage for contamination losses under first-party property insurance. A thorough analysis of the terms and conditions of standard property insurance policies reveals that pollution losses usually should fall outside the intended scope of coverage. Environmental claims under property insurance also should be excluded by express policy provisions that bar coverage for certain specified risks.

There are potential arguments, however, that contamination losses should be covered under traditional forms of property insurance. To counter such arguments, revised policy language has been adopted by many property insurers to clarify the policy intent that environmental losses are not covered absent a special endorsement expressly providing such coverage.

Additionally, in the Comprehensive Environmental Response, Compensation, and Liability Act, Congress determined that polluters should pay for the environmental damage they inflict. Allowing polluters to externalize pollution clean-up costs through property insurance coverage, however, will defeat the public policy objectives behind CERCLA. Requiring those who pollute to be directly responsible for the environmental consequences of their activities will encourage safety measures to prevent future pollution losses. The latter approach will encourage enhanced efforts to protect the environment.

Whether there is coverage for contamination claims under standard forms of property insurance policies is a question that must be left to the courts to decide on a jurisdiction-by-jurisdiction basis. Insurers should continue to insist, however, that the property insurance policies they issue should be enforced to exclude environmental coverage where none was intended.